NATIONAL CENTER FOR
THE MIDDLE MARKET

1Q 2017

MIDDLE MARKET INDICATOR

UNPRECEDENTED GROWTH, CONFIDENCE & OPTIMISM

IN COLLABORATION WITH

The Ohio State University
Fisher College of Business

SunTrust

Grant Thornton

Cisco

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

The National Center for the Middle Market is a collaboration between The Ohio State University's Fisher College of Business, SunTrust Banks Inc., Grant Thornton LLP, and Cisco Systems. It exists for a single purpose: to ensure that the vitality and robustness of middle market companies are fully realized as fundamental to our nation's economic outlook and prosperity. The Center is the leading source of knowledge, leadership, and innovative research on the middle market economy, providing critical data analysis, insights, and perspectives for companies, policymakers, and other key stakeholders, to help accelerate growth, increase competitiveness and create jobs in this sector. To learn more visit: www.middlemarketcenter.org.

U.S. MIDDLE MARKET DEFINED

ANNUAL REVENUE
RANGING FROM
$10MM – $1B

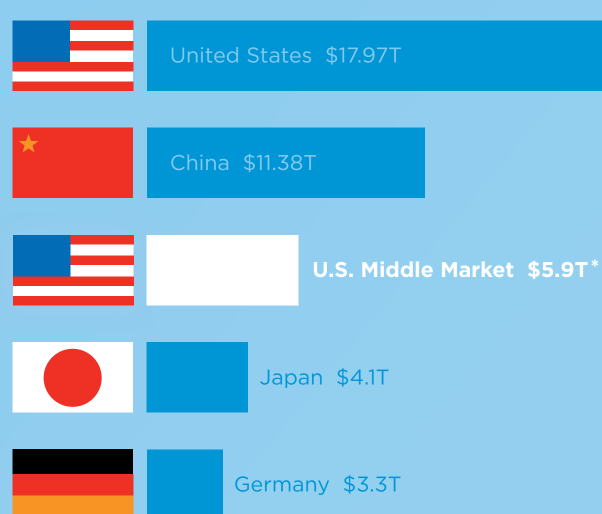
$ LOWER MIDDLE MARKET
$10MM - $50MM

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

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

NEARLY
200,000
BUSINESSES

3RD LARGEST
GLOBAL ECONOMY



*Source: 2015 CIA World Fact Book (not adjusted for purchasing power parity), *National Center for the Middle Market (estimate)*

Executive Summary

The U.S. Middle Market closed 2016 on a high note and has carried that momentum forward into 2017, with all indices pointing to an increasingly robust middle market. Actual and projected revenue and employment growth rates continue to rise significantly, and economic confidence is keeping pace, with all measures at their highest levels since the inception of the Middle Market Indicator in 2011. While every revenue segment and industry plays a part in the success story, the largest middle market firms (with revenues between $100 million and $1 billion) are driving rapid growth, and the construction industry in particular continues to report the most impressive gains, building on the trend seen last year. Middle market leaders clearly have an expansionary mindset for the year ahead, which includes a growing appetite for acquisitions; but companies will continue to face challenges as they grow. Changes in federal regulations and policies and the tightening labor market may present headwinds as companies aim to achieve their anticipated growth rates.

With the first quarter of 2017 under their belts, seven in 10 middle market leaders report that overall company performance has improved compared to last year. Just 5% of companies say performance has deteriorated. Middle market firms of all sizes rate themselves highly on business performance and operational excellence metrics. The largest middle market firms are more likely than their smaller counterparts to say they perform well in terms of innovation, customer acquisition, recruiting and retaining talented employees, and maintaining profit margins.

Over the past three quarters, the proportion of firms experiencing year-over-year revenue growth has steadily increased, with nearly three-quarters (74%) of firms reporting increases since Q1 2016. The revenue growth rate for the past 12 months is 9.2%, well above the five-year average of 6.6%. The largest middle market firms continue the upward trajectory seen last quarter, reporting revenue growth of 11.9%. Construction firms show the strongest performance, reporting an astonishing year-over-year growth rate of 20.5%, accounting in part for the dramatic spike in growth seen this quarter. However, when construction is removed from the equation, the rate of year-over-year revenue growth for the rest of the middle market remains an impressive 8.5%.

Innovation and new product development continue to be driving factors behind middle market growth, along with a surge in M&A activity. One-quarter of firms derive more than 20% of their revenue from recently introduced products, and 47% of middle market companies introduced a new product or service in the last 12 months. Companies are also growing through expansion into new domestic markets, and the number of companies making acquisitions has grown considerably over the last year.

From an employment perspective, more companies reported year-over-year employment increases this quarter than ever before in the history of the MMI. The overall middle market shows a 7.5% mean rate of employment growth since the first quarter of last year. With employment growth rates of 9.5% and 16.6% respectively, the largest middle market businesses and the construction industry are responsible for the most aggressive hiring. Once again, when construction numbers are removed, the year-over-year employment growth rate for the remainder of the middle market nets out at 7.0%. While 51% of businesses say the workforce expanded over the past 12 months, just 11% report decreases in employment. Compared to Q1 2012, when 22% of middle market firms reported dwindling workforces, the percentage of middle market firms that are currently downsizing has been cut in half.

Middle market leaders anticipate maintaining high growth rates in the year ahead. A slight majority of firms (51%) have plans to introduce a new product or service in 2017, and 45% say they will expand into new markets. The largest middle market companies maintain a particularly expansionary mindset, with 47% planning to add a new plant or facility and 42% expecting to make an acquisition in the year ahead. However, fewer than one-third of middle market companies anticipate needing to open a new line of credit or take on new debt in order to finance this growth.

Looking at the next three months, more executives, and especially leaders from the largest middle market companies, expect a better business climate, increased demand, and more sales in the short term. As a result, leaders anticipate unprecedented rates of revenue and employment growth over the next 12 months. Nearly six in 10 leaders expect revenue to grow at an average rate of 8.8%. More than four in 10 executives believe employment at their firms will increase by an expected mean total growth rate of 6.0%. Many companies plan to add new full-time jobs in the next quarter, mostly in the areas of operations, sales and marketing, and IT.

As middle market firms strive to meet the demands of growth, they will continue to be challenged by a tighter labor market, regulation changes, healthcare costs, and the need to efficiently expand and innovate while managing cash flow, costs, and profitability.

REVENUE GROWTH
Revenue growth swells

At 9.2%, the year-over-year revenue growth rate for middle market firms is significantly higher than any previous quarter in the history of the MMI. While construction companies report the highest growth, nearly doubling the growth rates reported last quarter, revenue growth is up across all industries, with the exception of wholesale trade. Companies at both ends of the middle market spectrum show remarkable increases for the past year, with the largest middle market firms reporting the most significant jump in growth rate. Core middle market firms indicate modest growth rate improvements over the past 12 months.

Middle market companies expect the rapid growth to continue throughout 2017, and projections for future growth are also at an all-time high. Close to six out of 10 leaders believe their firms will experience an increase in revenue growth this year. The largest middle market companies are the most optimistic, calling for a revenue growth rate of 11.4% over the next 12 months.

1Q'17 **74%** of middle market companies reported positive revenue growth. 1Q'16 69%

MIDDLE MARKET

PAST 12 MO.

1Q'17 9.2%

4Q'16 6.9% 1Q'16 6.3%

NEXT 12 MO.

1Q'17 8.8%

4Q'16 5.5% 1Q'16 4.6%

S&P 500

PAST 12 MO.

1Q'17 5.8%*

4Q'16 4.4% 1Q'16 -3.4%

EMPLOYMENT GROWTH
Hiring is on the rise

A slight majority (51%) of middle market businesses added to their employment rosters this year while only about one in 10 firms decreased the size of the workforce. All in all, the middle market reports an impressive mean year-over-year employment growth rate of 7.5%, up nearly two full percentage points from last quarter. As with revenue, the largest middle market companies and the construction industry account for the lion's share of growth; however all revenue segments and most industries report hiring.

At the end of 2016, middle market leaders projected a tapering off in the rate of employment growth. Those anticipations have shifted notably, with 42% of firms now reporting expected increases in employment for 2017, at a healthy mean rate of 6.0%. Again, the largest middle market companies lead the charge here, with these firms predicting workforce increases of 9.1% over the next 12 months, presumably to help drive their expected increases in revenue.

1Q'17 **42%** of middle market companies expect to add jobs. 1Q'16 34%

MIDDLE MARKET

PAST 12 MO.

1Q'17 7.5%

4Q'16 5.4% 1Q'16 3.6%

NEXT 12 MO.

1Q'17 6.0%

4Q'16 3.4% 1Q'16 2.7%

ADP [PAST 12 MO.]

LARGE CORP.

1Q'17 1.6%

4Q'16 2.4% 1Q'16 2.2%

SMALL BUS.

1Q'17 1.4%

4Q'16 1.4% 1Q'16 2.1%

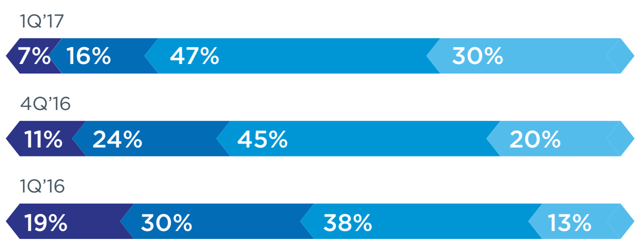
*1Q numbers include only companies who have reported 1Q earnings results. Numbers change as more businesses report financial results.

ECONOMIC CONFIDENCE
Confidence continues to grow

Economic confidence, which has been rising steadily since mid 2016, reached a new high at the end of the Q1 2017, with U.S. economic confidence levels surpassing local confidence for the first time in MMI history. Following a significant boost at the end of 2016, confidence levels continue to increase across the board—locally, nationally, and globally. This quarter, nine in 10 middle market leaders indicate a positive perception of the country's economy. Only slightly fewer (88%) believe the economy is solid in their own region.

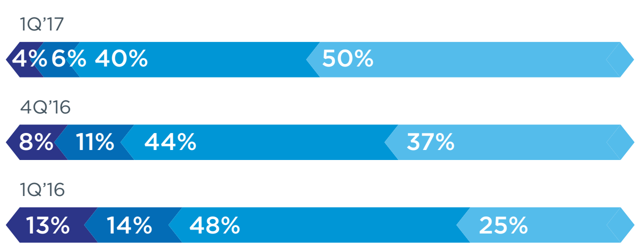
Perhaps due to greater familiarity and visibility, middle market executives have always expressed greater confidence in the state of affairs at home versus abroad. However, the gap between global and domestic confidence has been narrowing over the past year. Global confidence saw another 12-point jump this quarter, with more than three-quarters of middle market leaders currently feeling comfortable with economic conditions worldwide.

GLOBAL ECONOMY



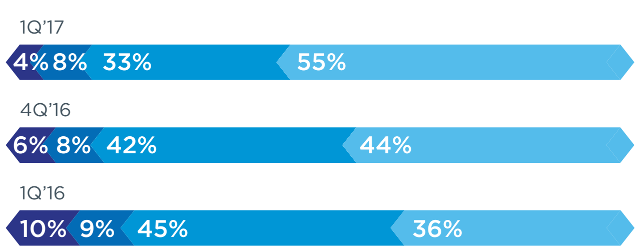
1Q'17
77%
CONFIDENT / SOMEWHAT CONFIDENT
4Q'16 65% 1Q'16 51%

NATIONAL ECONOMY



1Q'17
90%
CONFIDENT / SOMEWHAT CONFIDENT
4Q'16 81% 1Q'16 73%

LOCAL ECONOMY



1Q'17
88%
CONFIDENT / SOMEWHAT CONFIDENT
4Q'16 86% 1Q'16 81%

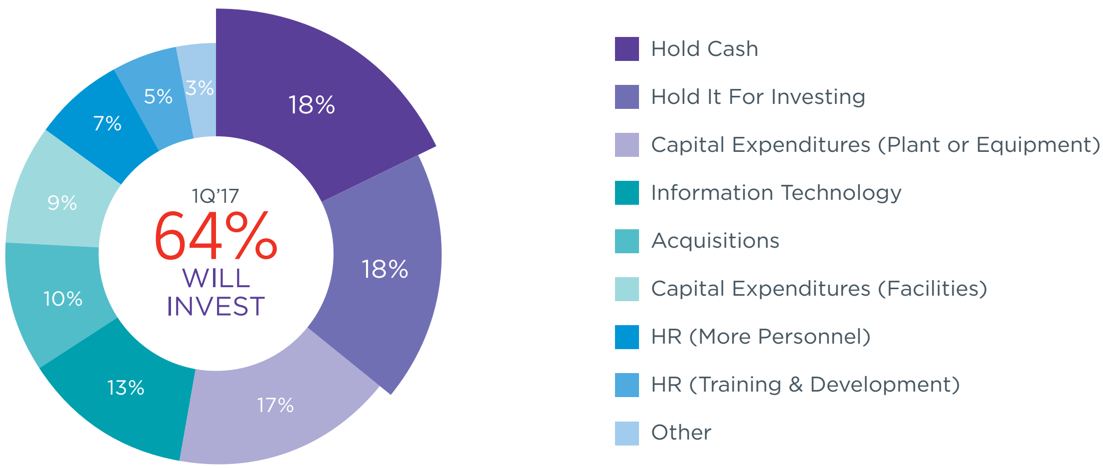
Not confident · Somewhat not confident · Somewhat confident · Confident

CAPITAL INVESTMENT
More companies plan to spend

Around two-thirds of middle market companies continue to say they would allocate extra dollars toward investment, a percentage that has remained relatively consistent since 2013. However, among the one-third of companies that prefer to save cash, fewer are building up cash reserves and more companies are saving for the purpose of future financial investments.

Capital expenditures for plants and equipment is the most likely area for investment in the next 12 months, with 34% of all middle market firms and nearly half (47%) of the largest middle market companies indicating a strong likelihood of adding a new plant or facility in the year ahead. Overall, an increasing proportion of middle market leaders say they expect their firm's capital expenditures to be higher this year than last.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES
Growth, talent issues, and political concerns present challenges

While middle market leaders fully anticipate growth in the coming year, they won't achieve it without overcoming some core issues. Following the recent trend, how to efficiently maintain growth and how to best manage talent remain the most pressing internal challenges. Specifically, executives worry about cash and inventory management as well as the ability to find and retain qualified workers.

Outside their four walls, leaders express concern over the changing nature of the marketplace and the political landscape. They speculate about the impact of politics on regulations and trade, as well as potential effects on public spending. Executives continue to contend with controlling costs, especially the cost of healthcare as well as fuel and material costs.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	64%
2. STAFF/EMPLOYEES	53%
3. COSTS	24%

EXTERNAL CHALLENGES:

1. BUSINESS	37%
2. GOVERNMENT	25%
3. COMPETITION	20%
4. ECONOMY	15%
5. COSTS	14%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. BUSINESS	40%
2. STAFF/EMPLOYEES	40%
3. COSTS	17%

EXTERNAL CHALLENGES:

1. BUSINESS	30%
2. GOVERNMENT	23%
3. COMPETITION	16%
4. COSTS	13%
5. ECONOMY	12%

Perspectives

The performance documented in this Middle Market Indicator is remarkable–in fact, the highest growth rates reported since the MMI was created in 2012. But the numbers are right: in the last 12 months, top-line revenue for middle market companies grew 9.2% on average; the previous high, 7.4%, came two years ago. Employment increased 7.5%, again faster than the previous record of 5% posted in the 4th quarter of 2014. The numbers are solid; they are also surprising. GDP grew 1.6% in 2017; from March 2016 to March 2017, overall employment increased 1.5%. How can we explain the middle market's numbers?

DEAL FEVER

The biggest cause is a surge in middle market M&A activity. Remember, a company that buys another will see revenue and employment rise, even if divisors like profitability or revenue per employee change little. In the last 12 months, 25% of middle market companies made an acquisition. That contrasts with 19% in the same period a year ago–an increase of nearly a third.

The most voracious acquirers were companies in the $100 million to $1 billion segment, which we call the upper middle market, 36% of which made an acquisition, up from 23% in the year-ago period; this group also grew fastest. Interestingly, public companies (which tend to be in the upper middle market) were less active in the deal market than others of their size (32% bought something), and also grew less. A lot less: Average top line growth was just 3.6%.

The data do not explain what lies behind the dramatic increase in deal-making, but a number of causes come to mind. First, a lot of capital is looking for work. The Macro Trends Group of the consulting firm Bain & Company estimates that total global financial capital has more tripled since the late 1990s. Private equity firms are launching large numbers of new funds. Prices paid are high relative to EBITDA, tempting people to sell who otherwise might not. Second, a major demographic transition is upon us, as baby-boomer owners look for the exit. Third, the specter of rising interest rates may be causing some executives to strike now rather than later when interest rates are higher.

Whatever the cause, the effect is clear: Acquirers grew twice as fast as the rest of the middle market. That doesn't mean they grew smarter or more profitably–but they sure did grow.

We also can credit some of the middle market's growth to construction companies, whose revenues rose a stunning 20.5% last year. Remove construction from the overall mix, and middle market growth was still a robust 8.5%. Nearly half of these builders expanded into new domestic markets, often by means of M&A. Thirty-four percent of construction companies made an acquisition last year, double the number the year before. A mild winter also spurred building projects.

	MADE ACQUISITION PAST YEAR	NO ACQUISITION PAST YEAR
Mean revenue growth	15.0%	7.3%
Mean employment growth	11.2%	6.3%
Projected revenue growth	12.6%	7.5%
Projected employment growth	8.9%	5.1%

Organic growth was strong, too, for almost all industries. Across the middle market, non-acquirers grew 7.3%, which exceeds the overall growth of the middle market for all but two quarters in the last five years.

The long-rising economic tide has lifted almost every middle market boat. Companies simply did better, in the same way that workers across the nation began to see bigger paychecks last year. Only 5% of middle market companies say overall performance deteriorated in the last year, 25% said it was unchanged, and 70% say it improved. A year ago those numbers were 6%, 36%, and 58%. Thus, one out of nine middle market companies went from no change to positive change–a delta that by itself would jolt the overall numbers higher.

Retail trade is a dark spot in this picture. Though retailers' revenue overall grew decently (6.8%–only wholesale grew less), 14% of retailers reported declining sales, a worrisome sign. Employment growth fell a point and a half–at 4.2%, it is the lowest in the middle market. Newspapers have headlined store closings by big retail chains, and the middle market is clearly not immune. Internet retailing is one cause of this sluggish growth, with big outfits like Amazon taking business from competitors of all sizes, but when it comes to employment we should not discount the increasing role of automation, as kiosks take over from cashiers. There may also be a secular shift in consumer spending: Data from the St. Louis Fed suggest that consumers are buying fewer things, like clothes, and more experiences, like travel and meals out.

BULLISHNESS

Many other signs point optimistically forward. The short-term middle market index–a projection of business conditions three months ahead–has reached 108, the highest number we have seen in two years. Overall economic confidence is the highest we have seen in five years–and for the first time ever, middle market executives express more confidence in the national economy than in their local economies. Some of this may be the so-called "Trump Bump" – MMI data were collected in early March. But capital spending plans show executives expect to put their money where their mouth is: 39% of middle market companies expect to increase capex in the next 12 months, a huge jump from 23% a year ago. And 40% expect deal-making to increase.

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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.

SUNTRUST

SunTrust Banks, Inc. is a purpose-driven company dedicated to Lighting the Way to Financial Well-Being for the people, businesses, and communities it serves. Headquartered in Atlanta, the Company has three business segments: Consumer Banking and Private Wealth Management, Wholesale Banking, and Mortgage Banking. Its flagship subsidiary, SunTrust Bank, operates an extensive branch and ATM network throughout the high-growth Southeast and Mid-Atlantic states, along with 24-hour digital access. Certain business lines serve consumer, commercial, corporate, and institutional clients nationally. As of September 30, 2016, SunTrust had total assets of $205 billion and total deposits of $159 billion. The Company provides deposit, credit, trust, investment, mortgage, asset management, securities brokerage, and capital market services. SunTrust leads onUp, a national movement inspiring Americans to build financial confidence. Join the movement at onUp.com.

Grant Thornton

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CISCO

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NATIONAL CENTER FOR
THE MIDDLE MARKET

2Q 2017

MIDDLE MARKET INDICATOR

SOLID GROWTH; STRONG EMPLOYMENT

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NEARLY
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3 RD LARGEST
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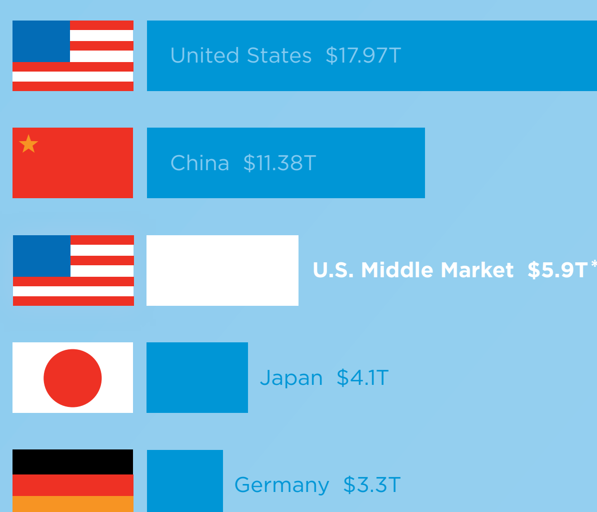

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Executive Summary

Following a record-setting first quarter, growth and confidence indices in the middle market have cooled slightly. Nevertheless, at the mid-year point, middle market firms continue to report strong performance, particularly for employment growth. The overall business atmosphere and outlook among middle market executives are decidedly positive. The largest middle market firms (with revenues between $100 million and $1 billion) maintain their trend of outperforming their smaller peers. Service and retail trade companies also continue to post strong numbers; in fact, the retail trade segment shows an increase in both the rate of year-over-year revenue and employment growth this quarter. Companies expect healthy growth to persist, both in the short- and long-term, and a significant percentage (especially larger firms) anticipate growing, in part, through merger and acquisition deals. However, finding enough of the right people to support growth is becoming more and more of a challenge for middle market leaders; concern over government activities is mounting as well.

The percentage of middle market leaders reporting improvements in company performance over the past 12 months fell slightly from last quarter, but at 65%, it remains above the historical MMI average of 61%. The percentage of executives reporting deteriorating conditions remains very low at just 5%. A slight majority of middle market firms believe they are outperforming their competitors and doing an excellent job of attracting new customers (55% and 51% respectively). Most say they are adept at managing banking relationships, leading their industries, and retaining profitable accounts. However, fewer than half rate themselves highly on innovation, sales force effectiveness, or ability to withstand an industry downturn.

At 72%, the proportion of firms reporting increases in gross revenue compared to one year ago remains near its peek level. This quarter, only 11% of firms say that revenue has decreased over the past 12 months. After surging last quarter, the rate of year-over-year revenue growth has slowed for all industries (with the exception of retail trade), but it remains robust at 6.7%. While growth is strong across all revenue segments, the largest middle market firms continue to grow the fastest, reporting an 8% gross revenue growth rate since mid 2016.

Expansion activity has remained consistent since the beginning of 2015. Over the past year, 45% of middle market companies introduced a new product or service and 38% expanded into new domestic markets. Additionally, 27% of the largest mid-sized firms made an acquisition. Companies say they spend 8% of revenues on product development, and about a quarter of firms (24%) say they derive 20% or more of their revenues from recently introduced offerings. However, in terms of innovation, companies say that the greatest impact on company performance stems from incremental improvements to existing products or services. A majority (53%) of middle market companies added jobs over the past 12 months and just 12% of firms downsized. The rate of employment growth remains high at 5.7% with the largest middle market companies increasing their headcount by 6.6%. Middle market leaders are generally satisfied with the capabilities of their workforce; most believe they have high-performing management teams and 63% say their employees are more productive than those at other firms.

The short-term middle market index, which measures anticipated changes in business climate, demand, and sales for the coming three months, is down from last quarter, but significantly higher than a year ago. Many leaders anticipate an increase in demand for products or services along with an increase in sales for the next three months, but they are more cautious in their assessment of the short-term business climate. The largest middle market companies tend to be the most optimistic about the near future.

Looking out across the next 12 months, companies expect both revenue and employment to grow, though projected growth rates have dropped in both areas. The new order pipeline continues to increase for more than one-third of middle market firms. While expansion expectations have dropped slightly, about four in 10 companies anticipate introducing new products or services and expanding into new domestic markets by mid 2018. Among the largest middle market companies, 35% say they will open a new plant or facility and 30% plan to make an acquisition. Fewer than a quarter of firms expect to take on new debt in order to fuel growth.

More than three-quarters (78%) of mid-sized firms say the size of their workforce is just about right, however, 42% say they will hire new people in the year ahead. The majority of new jobs will be full-time positions in operations and marketing and sales; the largest middle market firms anticipate increasing their IT staffs as well.

Finding the right people for these jobs may prove to be a challenge, however, with half of all middle market firms citing talent issues as a top concern for the year ahead. Many firms are considering improving salaries and offering flexible work arrangements to attract the best employees. Some firms are also looking at mergers and acquisitions as a means of acquiring new talent and leadership. Additional headwinds to growth include government regulations, changing market conditions, and increasing costs.

REVENUE GROWTH
Revenue growth returns to typical levels

After spiking to 9.2% last quarter, the year-over-year revenue growth rate in the middle market has settled back to 6.7%. While firms of all sizes and within all industries experienced this softening (with the exception of retail trade), overall middle market revenue growth is strong and slightly above the average growth rate of 6.6% for the past five and a half years. For the third consecutive quarter, the largest middle market companies report the highest rates of revenue growth. Service firms are also enjoying solid growth with a year-over-year growth rate of 9.9%.

Middle market leaders have toned down their expectations for the year ahead. At 5.5%, the projected growth rate for the next 12 months remains healthy and is half a point above the anticipated growth rates reported one year ago. Despite posting the highest rates of actual growth since Q4 2016 and showing the most optimism short-term, the largest middle market firms are the most conservative in estimating their growth for the year ahead.

2Q'17 **72%** of middle market companies reported positive revenue growth. 2Q'16 72%

MIDDLE MARKET

PAST 12 MO.

2Q'17 **6.7%**

1Q'17 9.2% 2Q'16 7.2%

NEXT 12 MO.

2Q'17 **5.3%**

1Q'17 8.8% 2Q'16 4.8%

S&P 500

PAST 12 MO.

2Q'17 **4.8%***

1Q'17 5.8% 2Q'16 1.2%

EMPLOYMENT GROWTH
Employment growth remains strong

More and more middle market companies are increasing the size of their staffs; this quarter, 53% of firms report year-over-year increases in employment. Like revenue growth rates, the 12-month employment growth rate has come back down from its surge last quarter. But at 5.7%, it is the second-highest rate of employment growth reported by the MMI, well above the five-and-a-half year average of 3.7%. Since the end of 2015, the largest middle market firms have been the most significant contributors to employment increases.

Over the next 12 months, 42% of firms expect to add to their headcount, and 35% expect to make hires in the short term, or the next three months. Overall, middle market companies expect employment growth to increase by 4.7% in the year ahead, an estimate that has decreased since last quarter, but is well above the employment projections made one year ago. The largest middle market firms will likely be responsible for providing the most new jobs.

2Q'17 **42%** of middle market companies expect to add jobs. 2Q'16 37%

MIDDLE MARKET

PAST 12 MO.

2Q'17 **5.7%**

1Q'17 7.5% 2Q'16 4.4%

NEXT 12 MO.

2Q'17 **4.7%**

1Q'17 6.0% 2Q'16 3.3%

ADP [PAST 12 MO.]

LARGE CORP.

2Q'17 **2.5%**

1Q'17 1.6% 2Q'16 2.3%

SMALL BUS.

2Q'17 **1.3%**

1Q'17 1.4% 2Q'16 1.9%

*2Q numbers include only companies who have reported 2Q earnings results. Numbers change as more businesses report financial results.

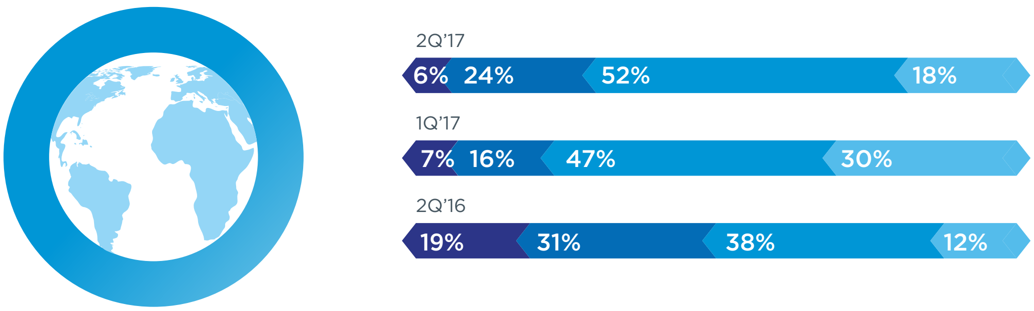
ECONOMIC CONFIDENCE

Confidence remains historically high

Although economic confidence levels have dipped slightly from record levels reported last quarter, confidence in local, state, and global economies remains well above their five-and-a-half year averages. As always, confidence is strongest closest to home, with more than eight in 10 executives reporting positive perceptions about their local and U.S. economies. Executives maintain a bullish outlook on the worldwide state of affairs as well, with seven out of 10 leaders saying they feel at least somewhat confident in the global economy.

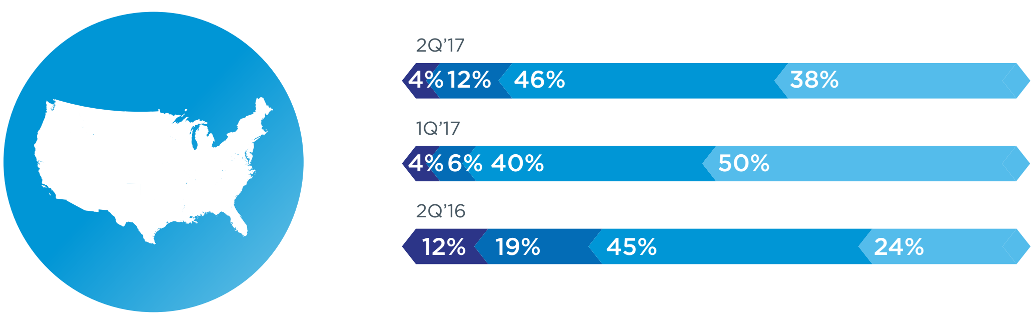
In fact, global confidence has risen the most dramatically over the past 12 months. Whereas local confidence has always been relatively high (the five-and-a-half year average is 78%), global economic confidence currently sits 20 points above its average of 50%. Much of that increase has come since the second quarter of 2016. Similarly, at 84%, national confidence is well above its average of 68%, and it, too, has climbed steadily since mid 2016.

GLOBAL ECONOMY



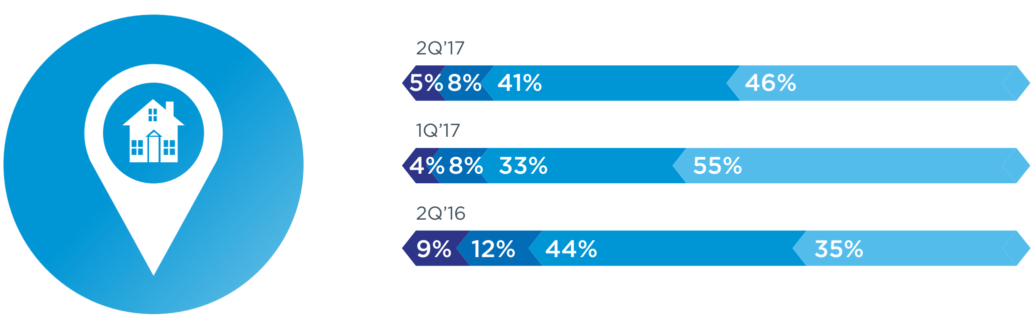
2Q'17
70%
CONFIDENT / SOMEWHAT CONFIDENT
1Q'17 77% 2Q'16 50%

NATIONAL ECONOMY



2Q'17
84%
CONFIDENT / SOMEWHAT CONFIDENT
1Q'17 90% 2Q'16 69%

LOCAL ECONOMY



2Q'17
87%
CONFIDENT / SOMEWHAT CONFIDENT
1Q'17 88% 2Q'16 79%

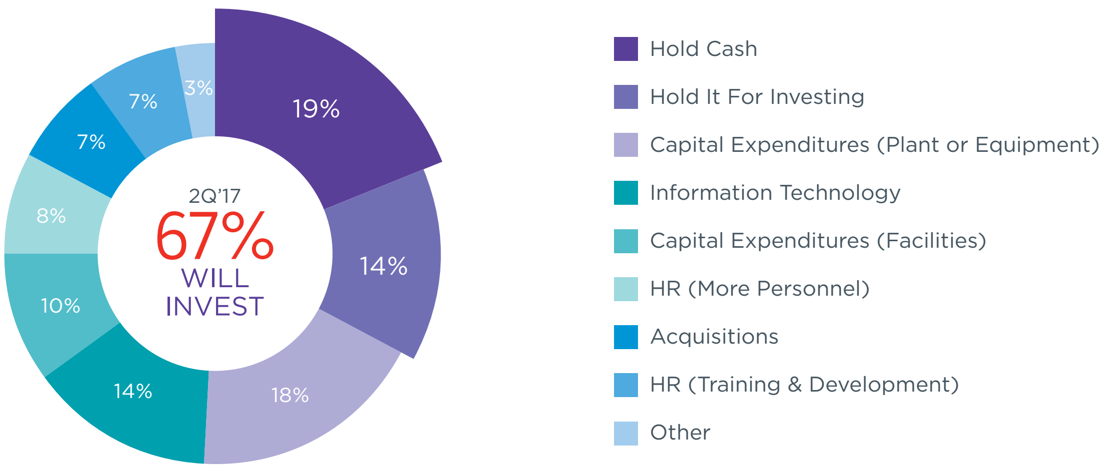
Not confident | Somewhat not confident | Somewhat confident | Confident

CAPITAL INVESTMENT

Most companies would invest extra cash

This quarter, close to seven out of 10 (67%) middle market leaders say they would invest an extra dollar as opposed to save it. While this percentage typically hovers right around two-thirds, it is up from 61% at the end of 2015. Only about two in 10 firms (19%) say they would save their money to hold more cash; the remaining 14% would save up for future financial investments. Capital expenditures for plants and equipment as well as information technology are the most likely areas of investment. A quarter of firms say there is strong likelihood of adding a new plant or facility in the next 12 months, and the larger the firm, the more likely it is to invest in this way.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Talent challenges and regulatory concerns are mounting

This quarter, half of middle market firms say that talent issues, including recruiting and retention, will be a primary concern over the next 12 months. This is up from 40% last quarter, and talent concerns have surpassed core business issues—such as maintaining growth and managing capital and cash flow—as the number one internal challenge for the year ahead. Externally, worries related to government are also on the rise, with more than a quarter (27%) of firms indicating that various political issues could have a significant impact on company performance. Middle market executives also continue to worry about changing market conditions, demand, and capital management issues. Healthcare costs are a concern for some, and executives cite minimum wage increases, increasing interest rates, and raw materials as other cost concerns.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	67%
2. STAFF/EMPLOYEES	57%
3. COSTS	29%

EXTERNAL CHALLENGES:

1. BUSINESS	37%
2. GOVERNMENT	29%
3. COMPETITION	22%
4. COSTS	16%
5. ECONOMY	12%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. STAFF/EMPLOYEES	50%
2. BUSINESS	43%
3. COSTS	19%

EXTERNAL CHALLENGES:

1. BUSINESS	31%
2. GOVERNMENT	27%
3. COMPETITION	18%
4. COSTS	15%
5. ECONOMY	10%

Perspectives

The performance of the U.S. middle market settled back to normal in the second quarter of 2017, following an exuberant performance in Q1. But it's important to note how remarkable "normal" is: Most companies would kill for 6.7% growth (the average rate reported this quarter) and would be stock market darlings if they delivered average annual growth of 6.6%, which the middle market has done for the last five years.

Almost everybody prospered over the last twelve months. Sixty-five percent of middle market leaders say their company's overall performance improved (vs. a five-year average of 61%), while just 5% said it deteriorated (the five-year average: 8%). With the exception of wholesale trade, every industry enjoyed strong, solid performance over the last twelve months, even retail. The "retail apocalypse" has spared the middle market so far, as the segment added both sales and jobs in substantial numbers. It is worth noting, however, that 18% of retailers told us they expect their industry to contract in the next 12 months, vs. 39% who expect expansion. That is the highest percentage of pessimists in the middle market. (By comparison, the percentage expecting contraction is 8% in construction, 10% in manufacturing, 12% in healthcare, 13% in services, 15% in financial services, and 16% in wholesale trade.)

THE BIG BREAK AWAY

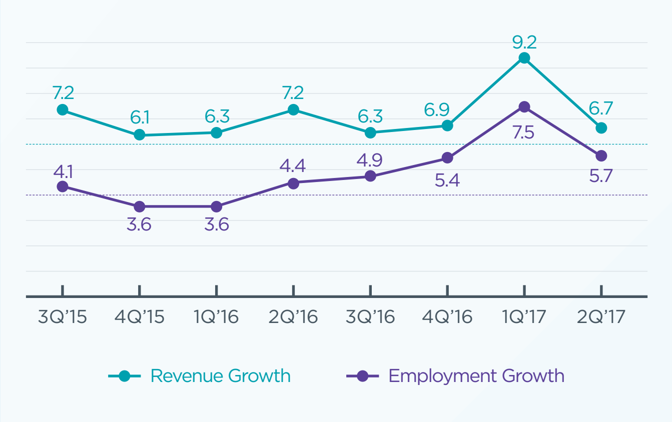
The picture is brightest for the biggest companies in the middle market, those with annual revenues between $100 million and $1 billion. Seventy-nine percent of this group reported increased revenue, and just 8% saw declines, compared to 72% and 11% for the middle market as a whole. Indeed, over the last eighteen months or so, the performance of the larger cohort has diverged, rising above that of core and small middle market firms in all but one quarter. Interestingly, this was not true between 2011 and 2014, when the three subsegments took turns leading the pack.

It is not hard to find explanations for the stronger performance of the upper segment of the middle market. They are expanding capacity; 28% added a new plant or facility in the last 12 months, compared to 17% for the core and 16% for the lower middle market. They are opening new geographic markets more aggressively. They are substantially more likely to have made an acquisition (27%, vs 13% and 17%). They invest a higher percentage of their already higher revenue on R&D (10.6% for the emerging large companies, 8.3% for the core, and 6.3% for the lower middle market–though it should be noted that core middle market companies are introducing new products and services slightly faster.

Given these investments, it is not surprising that larger middle market companies are outpacing the rest. It may be more curious that core and lower middle market companies kept pace with their larger siblings during the 2011-14 timespan. These bigger companies, one should note, are more likely to tap capital markets to finance their growth, which means that a steady, strong rise in interest rates could dampen their ardor for investment.

JOBS AND PRODUCTIVITY

A troubling trend could be hiding in the otherwise cheerful picture of the middle market. In the middle market, as in the economy as a whole, labor productivity–i.e. output per hour of work–is growing slowly if at all. This graph shows revenue and job increases side by side. The narrowing gap between them suggests that revenue gains in the middle market are being achieved by putting more people on the job, not by realizing more revenue per employee.



Now, the mysteries of productivity would baffle even Sherlock Holmes. The equations become even more complex in an Information Age service economy, because it is harder to measure both the dividend and the divisor. Economists say that stubbornly slow growth in labor productivity is one reason wages have risen more slowly than one would expect given how low the unemployment rate has become. Productivity should go up (with a lag) as a consequence of achieving economies of scale or of investing in new equipment and technology. If that is the case, we should start to see the impact of those upper-middle-market investments in the next few quarters.

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

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NATIONAL CENTER FOR
THE MIDDLE MARKET

3Q 2017

MIDDLE MARKET INDICATOR

STRONG GROWTH PERSISTS

IN COLLABORATION WITH

The Ohio State University
Fisher College of Business

SunTrust

Grant Thornton

Cisco

Middle Market Indicator
from the National Center for the Middle Market

EXECUTIVE SUMMARY

Thus far, 2017 is shaping up to be a record year for the middle market. In the first quarter, middle market companies reported an impressive surge in year-over-year revenue and employment growth rates, and those rates continue to remain above average in the third quarter. While revenue growth appears to be stabilizing at 7%, employment growth continues to escalate. Finding enough qualified employees to fill open positions may, however, be a challenge for executives given the tightening labor market. Some companies are looking at adding new and more unique benefits, such as financial, physical, and emotional well-being packages, to gain an edge when it comes to attracting talent.

More than two-thirds of middle market leaders report that overall company performance has improved in the past 12 months, while just 5% say that conditions have deteriorated. Seven out of 10 firms say revenues grew during this time period, and 41% say that their new-order pipelines have increased compared to one year ago, reporting an average bump of 13.2%. Around half of companies report increases in employment, and the current rate of year-over-year employment growth is nearly double the average rate since the MMI began.

Core and lower middle market companies (with annual revenues of $100 million or less), report faster revenue growth rates and a more positive future outlook than their larger counterparts this quarter. Despite a decrease in the rate of revenue growth for upper middle market companies (with $100 million to $1 billion in annual revenue), these firms are doing, and expect to continue to do, the majority of the hiring. From an industry perspective, business services, financial services, and healthcare companies are growing the fastest, while retail employment growth has tapered off significantly.

Leaders continue to report strong confidence in the economy. This confidence, coupled with anticipated future growth, is likely propelling increased willingness to invest. Investment dollars are more likely to be geared toward IT, new plants, and equipment than toward training and development for employees despite the fact that talent concerns continue to mount. The ability to recruit and retain people will be a top challenge for companies in the year ahead.

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.

REVENUE GROWTH
Revenue growth stabilizes

Following a rapid surge in the first quarter, year-over-year revenue growth rates settled back to average in Q2. This quarter, growth rates accelerated slightly and appear to be stabilizing at a healthy 7.0%. Core middle market companies report the largest jump; at 9.2%, their revenue growth rate surpassed that of upper middle market companies for the first time since Q3 2016. For their part, the middle market firms at the high end of the revenue spectrum reported declining growth rates for the second straight quarter.

A majority of middle market firms expect the rate of revenue growth to increase in the year ahead, particularly core and lower middle market firms. Across the middle market, companies anticipate 6.0% growth, up from 5.3% last quarter. However, upper middle market companies are more conservative, anticipating growth rates of just 4.5%. A mere 5% of companies expect the rate of revenue growth to decline over the next 12 months.

3Q'17 **70%** of middle market companies reported positive revenue growth. 3Q'16 63%

MIDDLE MARKET

PAST 12 MO.

3Q'17 7.0%

2Q'17 6.7% 3Q'16 6.3%

NEXT 12 MO.

3Q'17 6.0%

2Q'17 5.3% 3Q'16 4.9%

S&P 500

PAST 12 MO.

3Q'17 4.4%*

2Q'17 5.8% 3Q'16 2.5%

EMPLOYMENT GROWTH
Hiring stays strong

Nearly half (48%) of middle market companies say their workforce is larger today than it was one year ago. Companies have increased headcount by 6.4% since Q3 2016, representing the second highest year-over-year employment growth rate in MMI history. While upper middle market firms are growing more slowly, they continue to be the most aggressive hirers, posting an 8.4% year-over-year employment growth rate. Core middle market companies also contribute significantly to the uptick in employment this quarter.

Expectations for future employment growth remain stable and healthy at 4.7%. More than four in 10 companies (42%) anticipate adding workers over the next year, and upper middle market firms are the most likely to anticipate increases in headcount. About a third of firms have plans to hire in the next three months. Most of the new jobs will be full-time positions and will primarily be in operations, marketing, and sales.

3Q'17 **42%** of middle market companies expect to add jobs. 3Q'16 37%

MIDDLE MARKET

PAST 12 MO.

3Q'17 6.4%

2Q'17 5.7% 3Q'16 4.9%

NEXT 12 MO.

3Q'17 4.7%

2Q'17 4.7% 3Q'16 4.0%

ADP [PAST 12 MO.]

LARGE CORP.

3Q'17 2.8%

2Q'17 1.6% 3Q'16 2.3%

SMALL BUS.

3Q'17 1.2%

2Q'17 1.4% 3Q'16 1.8%

*3Q numbers include only companies who have reported 3Q earnings results. Numbers change as more businesses report financial results.

ECONOMIC CONFIDENCE
Leaders remain confident

Middle market leaders continue to report solid confidence in the economy close to home as well abroad. Local and global confidence levels are particularly strong this quarter. At 88%, local confidence matches its peak level and is especially strong in the western and southern regions of the country, although it has dipped slightly in the Northeast. Global confidence, at 74%, is at the second highest level reported by the MMI. National confidence also remains well above average, although it has dipped just slightly for the second straight quarter.

Still, with 83% of middle market business leaders reporting positive perceptions about the U.S. economy, it is clear that the middle market feels decidedly upbeat regarding business conditions across the nation, especially companies in the Midwest. High confidence levels are likely helping to bolster increases in anticipated revenue and employment growth rates for many middle market companies.

GLOBAL ECONOMY

3Q'17
74%
CONFIDENT / SOMEWHAT CONFIDENT
2Q'17 70% 3Q'16 56%

NATIONAL ECONOMY

3Q'17
83%
CONFIDENT / SOMEWHAT CONFIDENT
2Q'17 84% 3Q'16 71%

LOCAL ECONOMY

3Q'17
88%
CONFIDENT / SOMEWHAT CONFIDENT
2Q'17 87% 3Q'16 80%

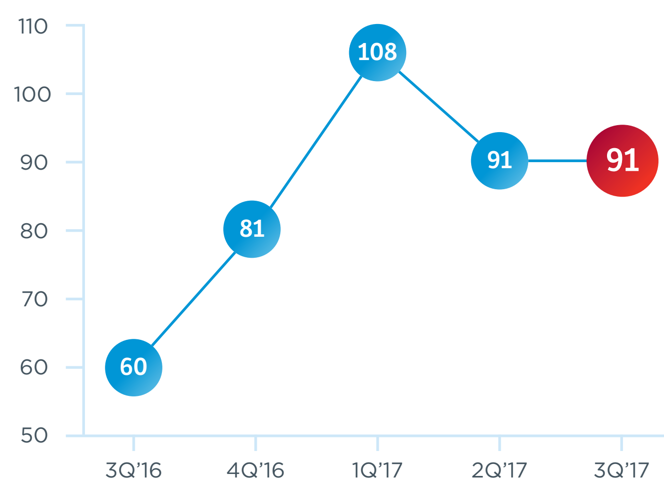
SHORT TERM INDEX
Short term index holds steady

The Short Term Index is calculated based on expected net positive change in business climate, expected net positive change in demand, and expected next positive change in sales for the next three months. The index rose rapidly during the second half of 2016 and peaked in Q1 2017. It fell slightly last quarter, and this quarter it remains steady and strong at 91.

Over a quarter (27%) of middle market business leaders anticipate a more favorable business climate in the next three months and nearly half (49%) say sales will increase in the short term. More than four in 10 expect an increase in demand for their products or services as the year finishes out, a percentage that has remained steady all year long.

Fewer than one in 10 leaders expect the business climate to deteriorate in the last quarter of 2017. Just 5% of business leaders forecast a decrease in demand or a decrease in sales as we head into the fourth quarter. Lower middle market firms are less optimistic about the three months ahead than their larger peers, and most of these companies expect the business climate, sales, and demand to hold steady throughout the remainder of the year.

PAST 12 MONTHS

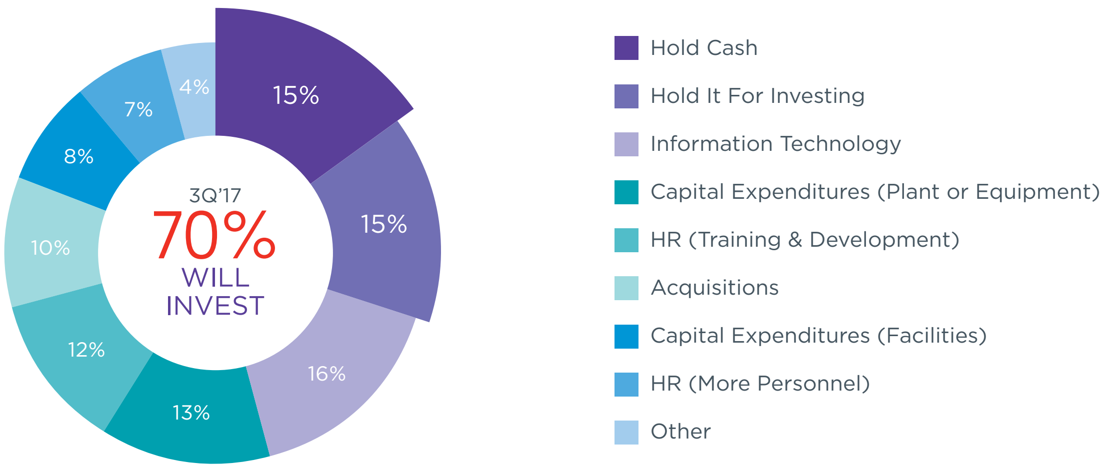


Short Term Index is calculated by taking expected net positive change in business climate plus expected net positive change in demand plus expected net positive change in sales over the next 3 months.

CAPITAL INVESTMENT
Investment appetites increase

For the first time in MMI history, the proportion of middle market leaders who say they would invest extra cash instead of save it has risen to 70%. Additionally, among the 30% of leaders who prefer to save cash, a majority say they are saving for future investments as opposed to simply putting money aside. Information technology is the most likely area for future investment, followed by capital expenditures for plant and equipment. Upper middle market companies are slightly more likely to invest, especially in the area of plant and equipment. Overall, 26% of middle market firms anticipate adding a new plant or facility in the next 12 months; that percentage has trended slowly up for the last five years.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES
Talent concerns are high and rising

Concerns over talent retention and recruitment are on the rise for the second straight quarter. Talent issues will be a challenge for a majority of middle market firms (51%), especially as many firms anticipate hiring more aggressively and the labor market continues to tighten. Accordingly, middle market companies are three times more likely to add to their benefits packages than to reduce them (see Spotlight, page 6). More companies voice concerns over core business issues, including maintaining growth and managing capital.

Competition is mounting, and some companies express worry related to the increase in acquisitions in their industries. Our data suggest most believe costs are under control. However, concern about costs has been inching higher over the last three years, and this quarter marks the first time that more than 20% of executives put costs on their list of top challenges. The concerns are across the board: healthcare, wages, materials, construction. Worries related to government regulations have eased.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1.	BUSINESS	65%
2.	STAFF/EMPLOYEES	59%
3.	COSTS	22%

EXTERNAL CHALLENGES:

1.	BUSINESS	41%
2.	COMPETITION	25%
3.	GOVERNMENT	25%
4.	ECONOMY	18%
5.	COSTS	18%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1.	STAFF/EMPLOYEES	51%
2.	BUSINESS	48%
3.	COSTS	21%

EXTERNAL CHALLENGES:

1.	BUSINESS	34%
2.	GOVERNMENT	22%
3.	COMPETITION	22%
4.	ECONOMY	16%
5.	COSTS	14%

SPOTLIGHT

EMPLOYEE VALUE PROPOSITIONS: A TOOL FOR ATTRACTING TALENT

Given recent high rates of year-over-year employment growth, it's not surprising that middle market companies cite talent issues as a top challenge. Companies need qualified people to help support growth, and those people can be difficult to find.

One way companies can attract the best talent is by enhancing their employee value propositions, or the complete package of benefits and opportunities that employees receive in exchange for working for a firm. Middle market companies appear equally split between three approaches to benefits: *Minimizers* offer only what's expected. *Competitors* offer expanded services to keep up with peers. And *Differentiators* use benefits as a strategic tool for attracting the best talent. In terms of ownership structures, partnerships tend to be more strategic than companies with other ownership types, while public firms and non-profits are much more likely to match the competition. Interestingly, Competitors show the fastest revenue growth and Minimizers are posting the highest employment growth rates and expect the greatest increases in headcount in the year to come.

From an industry perspective, the fastest-growing segments, including business services, financial services, and healthcare, offer the most diverse benefits packages. It's not surprising that slower-growing industries, namely retail and wholesale, offer less comprehensive benefits. Yet, executives in these industries appear to be no less satisfied with the benefits they offer than their peers whose packages are more robust, presumably because their bar is lower.

Retailers, however, are most concerned about the financial well-being of their employees, probably because pay tends to be lower in this industry. But they are not alone. Most leaders across all industries are at least somewhat concerned about employees' financial health. And some are doing something about it: Indeed, financial wellness packages, along with physical and emotional wellness, are emerging benefit areas that some companies, upper middle market firms in particular, are considering adding to attract more employees.

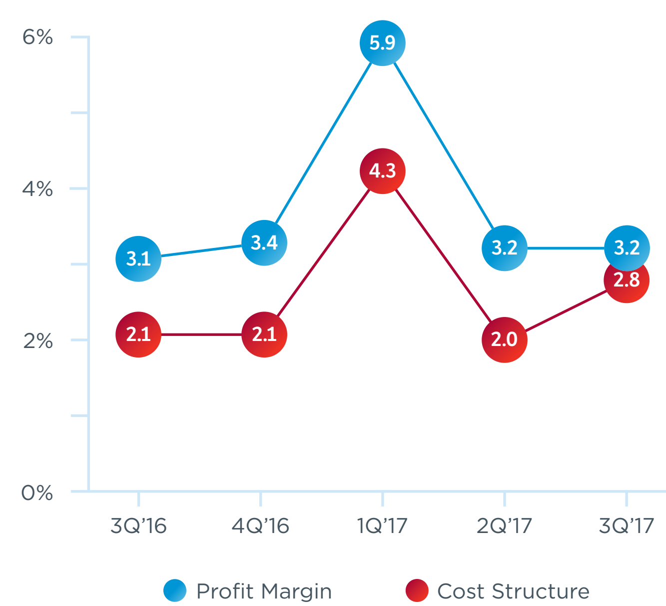
PROFIT MARGINS & COST STRUCTURE

Profits and costs will rise

Over the next 12 months, middle market leaders anticipate an increase in profit margins of just over 3%. While the majority of firms will keep their product and service prices consistent over the next year, four in 10 businesses will initiate pricing increases. Only 5% of firms expect to bring prices down.

Company cost structure is expected to increase as well, but to a slightly lesser degree—that is, companies expect their profits to increase faster than costs do. Most middle market leaders believe that the cost of healthcare will have a moderate to significant impact on their businesses in the year ahead. The majority also believe that energy costs will have an impact on company performance, but healthcare costs are clearly the more pressing concern. Inventory may also impact cost structure. Just under one third of firms say they are holding more inventory today than they were one year ago. Only one in 10 firms has decreased inventory levels.

PAST 12 MONTHS



Perspectives

As of this date—October 2017—the U.S. economy has expanded for one hundred consecutive months. That is the third-longest period of uninterrupted growth in U.S. economic history. The longest, 120 months, came in the 1990s; the expansion of the 1960s lasted 106 months. The current expansion has not been rapid; no one would call it a boom. It has not been evenly distributed across places and populations. But it has been extraordinarily long-lived.

It has also been led by middle market companies. In the last five years, non-farm employment in the United States has increased from 142 to 154 million—roughly eight percent. The middle market has added jobs at a rate of 5.5% a year. That figure includes inorganic growth, so it is not apples-to-apples with overall employment. But quarter after quarter, comparable data show middle market employment rising at least twice as fast as employment in smaller or bigger companies. The same holds for top-line growth, which for the middle market has dipped below 6% only four times in the last 20 quarters.

We have noted before how benign the economic climate has been, with negligible inflation, persistently low costs for capital, talent, and energy, and robust equity markets. (This this is the second-longest bull market in history.) Microeconomic signals are green, too. Executives expect profits to rise faster than costs. Forty-one percent of companies say their new-order pipeline has grown, a number that is 10 full percentage points higher than it was at this time in 2016. Among those with fuller pipelines, the average increase is a very robust 13.2%.

Given all this, it is no wonder that middle market executives expressed this quarter their highest-ever level of confidence in their local economies, second-highest ever confidence in the global economy, and third-highest-ever confidence in the U.S. economy. They also say that they will back that confidence with actions designed to secure and extend their growth.

COMPANY INVESTMENT PLANS, NEXT 12 MONTHS	3Q 2017	3Q 2016
Will expand into new domestic markets	44%	36%
Plan to open new foreign markets	23%	16%
Plan to open a new plant or facility	26%	19%
Plan to make an acquisition	25%	22%
Plan to take on new debt	22%	15%

These are plans, not promises; but historically middle market companies have kept close to plan. For example, a year ago 37% planned new domestic expansion, and 36% actually did it.

This worm will turn; worms always do. While the middle market does not seem to face macroeconomic headwinds, there are considerable uncertainties. Company valuations, sovereign debt, and political risk all are high. Trade agreements are being challenged. These or other factors could put an end to the good times, and they will be obvious only in retrospect, and out of executives' hands. Two major challenges are more under executives' control.

The first challenge: Talent shortages. Four out of 10 executives say a lack of talent constrains their growth. Executives cannot do much about workforce participation rates, which are affected by factors like an aging population, immigration, and labor lost to opioid addiction. But only 35% of middle market job vacancies are filled by promotion from within, which suggests companies experiencing labor shortages should rely less on the tight outside labor market and invest more in training, developing career paths for employees, and enhancing the employee value proposition to increase retention.

The second challenge: The middle market, like the rest of the economy, is not getting much in the way of labor-productivity improvement. For the last two quarters, revenue growth and employment growth have converged. In 2014, we noted that job growth was trailing revenue grow substantially—in the third quarter of 2014, the two numbers were 7.5 and 3.5, respectively. At that time we wondered if executives were being too cautious about hiring. Now it appears that they are getting fewer gains in productivity than they should—perhaps an indication that they are holding back on capital spending.

The paradox: If they could solve the productivity problem, they would also reduce the talent-shortage problem.

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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.

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NATIONAL CENTER FOR
THE MIDDLE MARKET

4Q 2017

MIDDLE MARKET INDICATOR

REVENUE GROWTH ACCELERATES, EMPLOYMENT GROWTH SLOWS

IN COLLABORATION WITH

THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS

SUNTRUST

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Middle Market Indicator
from the National Center for the Middle Market

EXECUTIVE SUMMARY

For the middle market, 2017 can be summed up as a year of strong growth in both revenue and employment. The proportion of middle market businesses reporting improved year-over-year company performance is at its highest level (71%) in the six years of the MMI. Companies ended the year with a year-over-year revenue growth rate of 7.6%—second only to the rate reported in 1Q'17. While the employment growth rate fluctuated throughout the year, leaders report a 5.2% increase in headcount for 2017, and over half of firms added people to their rosters. Overall, the year was the strongest year for middle market employment growth in MMI history. Confidence levels are at near record highs to close the year, and a large majority of leaders prefer investing extra cash as opposed to saving it.

Yet middle market leaders are no strangers to challenges and headwinds. They are increasingly concerned about how to maintain the growth they have experienced in recent years and how to keep up with changing market conditions. In particular, half of firms say they struggle to find and retain the talent they need to achieve the growth they seek. And they are becoming more and more sensitive to the cost of doing business, particularly as it relates to healthcare and the expenses associated with finding and keeping the right people on board.

As leaders look ahead to 2018, they are optimistic. In the short term, sales and demand expectations have eroded slightly. However, more leaders expect to find a more favorable business climate in the next three months, and nearly a third plan to expand their workforces in the first quarter of 2018. Over the course of the year, companies project a healthy 5.4% rate of revenue growth. Employment is anticipated to grow more slowly: 43% of businesses expect to add workers this year and expect growing their workforces by 3.7%. These somewhat muted expectations may be a result of the shrinking size of the labor pool as the economy nears full employment: a solid majority (81%) say their workforce is just about the right size for current market conditions.

While all industry segments experienced growth in 2017, business services, construction, and financial services firms have grown the most rapidly. With the exception of construction, all industries have slowed the rate of hiring slightly. Upper middle market companies, with revenues between $100 million and $1 billion, have slowed their employment growth rates the most notably this quarter. However, after two consecutive quarters of reporting decreases in year-over-year revenue growth, the largest middle market businesses once again report the fastest rates of revenue growth for 4Q'17.

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.

REVENUE GROWTH
Revenue growth climbs

Three-quarters of middle market firms report increases in revenue over the past 12 months. After falling from an all-time high at the beginning of the year, the rate of revenue growth has accelerated the past two quarters. To close out 2017, companies report a year-over-year revenue growth rate of 7.6%, up from 6.9% at the end of 2016 and almost a full point above the six-year average revenue growth rate of 6.7%. Middle market companies of all sizes are growing their revenues faster than the historical average.

In 2018, most middle market companies (62%) expect revenue to continue to grow. They anticipate a healthy revenue growth rate of 5.4%—a percentage that has fluctuated somewhat this year, but that is consistent with what companies anticipated at the close of 2016. Middle market companies with annual revenue of $50 million or more are more optimistic than the lower middle market regarding growth in the year ahead.

4Q'17 **75%** of middle market companies reported positive revenue growth. 4Q'16 70%

MIDDLE MARKET

	PAST 12 MO.	NEXT 12 MO.
4Q'17	7.6%	5.4%
3Q'17	7.0%	6.0%
4Q'16	6.9%	5.5%

S&P 500

	PAST 12 MO.
4Q'17	6.9%*
3Q'17	4.4%
4Q'16	4.4%

EMPLOYMENT GROWTH
Hiring rates slow

A majority (52%) of middle market companies increased the size of their workforce in 2017. The rate of employment growth fluctuated throughout the year. Companies report 5.2% year-over-year growth for 4Q, down from 6.4% last quarter, but on par with the 5.4% growth rate reported at the close of 2016. Overall, the rate of employment growth has cooled off this year. However, hiring in the middle market remains decidedly strong and well above the average employment growth rate of 3.9% as measured by the MMI.

Expectations for future employment growth have also declined over the course of the year. More than four out of 10 businesses (43%) do expect to hire in 2018, and about a third of companies (32%) say they will make workforce increases in the first quarter of the year. But the anticipated rate of employment growth for the year ahead is down to 3.7%. Companies will continue to add full-time workers primarily in operations, marketing and sales, and IT.

4Q'17 **43%** of middle market companies expect to add jobs. 4Q'16 33%

MIDDLE MARKET

	PAST 12 MO.	NEXT 12 MO.
4Q'17	5.2%	3.7%
3Q'17	6.4%	4.7%
4Q'16	5.4%	3.4%

ADP [PAST 12 MO.]

	LARGE CORP.	SMALL BUS.
4Q'17	2.6%	1.4%
3Q'17	2.8%	1.2%
4Q'16	2.4%	1.4%

**4Q numbers include only companies who have reported 4Q earnings results. Numbers change as more businesses report financial results.*

ECONOMIC CONFIDENCE
Confidence stays strong

Middle market leaders remain optimistic about economic conditions both at home and abroad. Local economy confidence closed out the year at 88%, just off its all time high and a couple of points above the 4Q'16 number. After a slight dip in 2Q17, global economic confidence has climbed back to 75%. Eighty-six percent of middle market executives are very or highly confidence in the U.S. economy, a near-record percentage. Across the board, economic confidence levels are well above the average levels measured by the MMI. Compared to mid 2012, when fewer than half of leaders reported confidence in the U.S. economy and fewer than a quarter had positive perceptions about the global state of affairs, there has been a dramatic shift in attitudes. Today, leaders appear steadfast in their belief that economic conditions are healthy and strong everywhere their businesses operate.

GLOBAL ECONOMY

4Q'17
75%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'17 74% 4Q'16 65%

NATIONAL ECONOMY

4Q'17
86%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'17 83% 4Q'16 81%

LOCAL ECONOMY

4Q'17
88%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'17 88% 4Q'16 86%

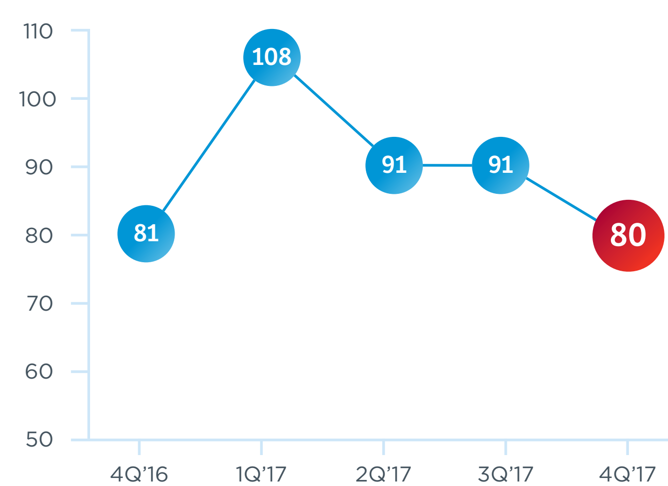
SHORT TERM INDEX
Short term expectations cool

Since climbing to peak levels in the first quarter of 2017, the Short Term Middle Market Index has tapered off throughout the year. The index is created by combining leaders' expectations regarding the business climate, demand, and sales for the three months ahead. At 80, the index is at the lowest level recorded since the close of 2016. Nonetheless, it remains higher than average since the National Center for the Middle Market began calculating this measure in 2015.

The percentage of business leaders saying they anticipate increases in demand and sales in the short term is down compared to three months ago, which accounts for the dip in the index this quarter. For the most part, executives believe these numbers will hold steady for the first quarter of 2018. Fewer than one in 10 leaders expect sales and demand to decline over the next three months.

Interestingly, the proportion of firms expecting a more favorable business climate in the next three months is slightly higher than in 3Q, with 30% saying conditions should improve in the short term. Upper middle market companies are a bit less optimistic than their smaller peers about the outlook for the business climate over the next three months.

PAST 12 MONTHS

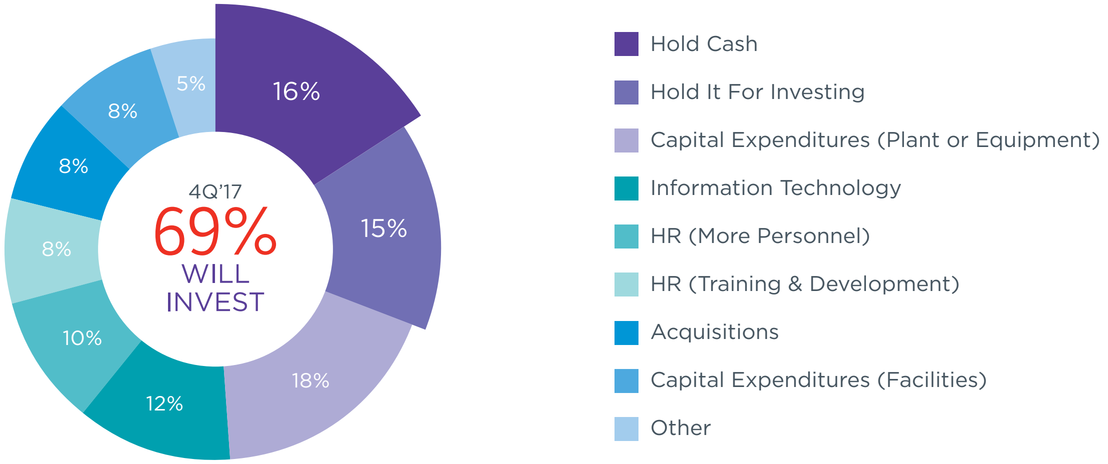


Short Term Index is calculated by taking expected net positive change in business climate plus expected net positive change in demand plus expected net positive change in sales over the next 3 months.

CAPITAL INVESTMENT
Companies will invest in growth

The proportion of firms that would invest extra money as opposed to hold it remains near peak levels. The percentage has risen slowly but surely since mid-2012 when the investors and savers were nearly equally split. Today, 69% of companies say they would put an extra dollar of revenue to work immediately via investment, primarily through new plants and equipment or IT improvements or upgrades. In 2018, 22% of companies say they are highly likely to add a new plant or facility. Among the 31% of companies indicating that they would hold on to cash, about half say they are saving for future investments. Just 16% of middle market businesses would hold additional revenue in a cash reserve.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES
Cost and competition concerns heat up

Talent management concerns, including those related to retention and recruitment, remain the top internal long-term challenge for middle market business leaders, as they have been throughout 2017. Half of business leaders claim that talent is an issue for their companies. However, cost concerns have risen throughout the year, with close to a quarter (22%) of executives now citing costs as a long-term challenge. (See spotlight on the next page). Managing healthcare costs remains an issue. Companies are also feeling salary pressure and may need to increase their recruiting and labor expenses due in part to a tightening labor market. Externally, leaders are most likely to lose sleep over how to maintain the growth they are experiencing and how to keep up with changing market conditions. Competition is on the rise, especially from larger companies that may have more flexibility to reduce prices, and external cost concerns are up, too. However, worries related to government and regulations continue to ease.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	**71%**
2. TALENT MANAGEMENT	**56%**
3. COSTS	**23%**

EXTERNAL CHALLENGES:

1. BUSINESS	**40%**
2. COMPETITION	**28%**
3. GOVERNMENT	**23%**
4. COSTS	**15%**
5. ECONOMY	**12%**

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. TALENT MANAGEMENT	**50%**
2. BUSINESS	**47%**
3. COSTS	**22%**

EXTERNAL CHALLENGES:

1. BUSINESS	**37%**
2. COMPETITION	**23%**
3. GOVERNMENT	**21%**
4. COSTS	**19%**
5. ECONOMY	**13%**

SPOTLIGHT

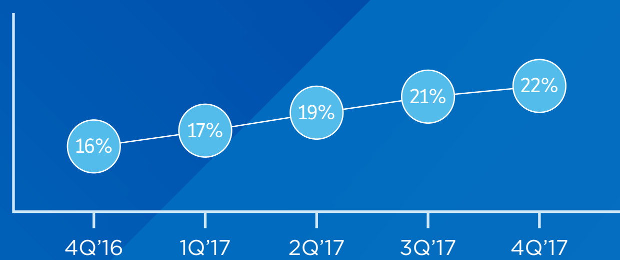
PIPELINES, PRICES, AND PLANNING FOR CONTINUED GROWTH

The Q4 MMI—and every quarter of 2017—has been rosy. But a couple of dark spots are embedded in it. One is a softening in the new order pipeline: Companies reporting increases in their pipelines dropped from 41% in 3Q to 35% in 4Q. That remains a strong number (it compares to 31% in 4Q 2016) but it was enough to pull down the short-term index. Of more concern: Among those with larger new order pipelines, the average amount of the increase fell all year, from 18.4% to 12.1%.

At the same time, anxiety about costs has risen for four straight quarters. While a cost issue is named as a top-three concern by just 22% of executives (vs. 50% who name a talent issue), that figure was 16% a year ago. One person's cost increase is another person's price increase, and we see that, too: 48% of companies expect to raise prices next year, which is up eight points from 4Q'16 and the highest number we have seen. Executives worry especially about managing healthcare costs (particularly at smaller firms). These data do not reflect whatever impact tax-law and other policy changes may have on costs or other aspects of business.

The picture points to growing complexity: While growth and profitability continue to be very strong, executives say the challenge of managing and sustaining them seems more difficult. The level of concern for all long-term business issues—not just costs—has risen in the last year. Not surprisingly, the two subjects that top leaders' lists as things they want to know more about are strategic planning and creating a high-performance culture—both capabilities that will help a company handle whatever curveballs the economy throws at them.

EXECUTIVES CITING A COST ISSUE AMONG THEIR TOP THREE INTERNAL CHALLENGES



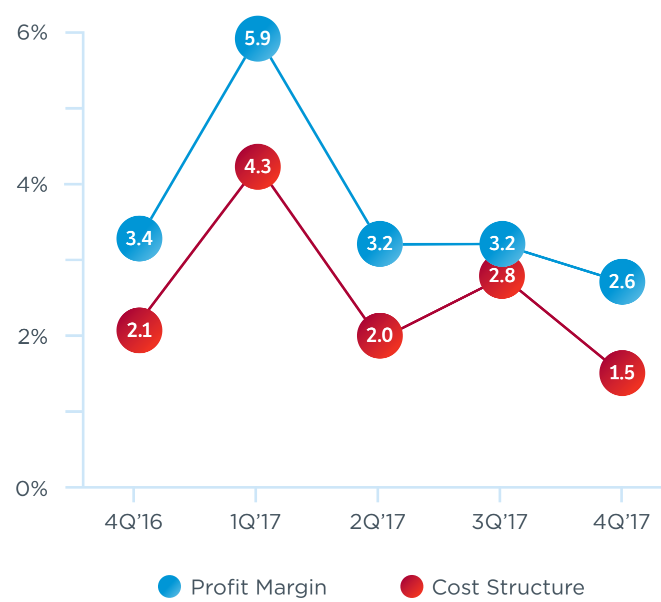
PROFIT MARGINS & COST STRUCTURE

Profit margins and costs will rise more slowly

Middle market companies expect their profit margins to increase in 2018, but to a lesser extent this year than last. For the most part, middle market executives believe that they will be able to manage revenues and costs in such a way that profit margins will increase. At 2.6%, the percentage of profit-margin increase is the lowest in the last year (even leaving aside the anomalously high numbers from the first quarter of 2017). For the year ahead, leaders anticipate much more modest increases of 2.6%. However, the proportion of businesses saying they will raise prices is up significantly from three years ago. In 2018, nearly half (48%) of middle market businesses say they will charge more for their products and services.

Leaders have also moderated their expectations when it comes to cost increases in 2018. They say cost structure over the next 12 months will increase by 1.5%, down from the 2.8% they speculated a quarter ago. Healthcare costs remain a major concern and companies believe the cost of healthcare will have a significantly greater impact on their bottom lines than the cost of energy.

PAST 12 MONTHS



Perspectives

How's business?

One question on the Middle Market Indicator survey asks executives whether their company's overall performance has improved, deteriorated, or stayed the same in the last year. This quarter, the ratio of companies saying their performance was better to those who felt it had weakened was approximately 12 to 1. When the MMI was launched in April 2012, that ratio was approximately 5 to 1; furthermore, over the six-year history of the MMI, the average ratio has been 8 to 1. By this point, the economic tide has lifted just about every boat.

Past performance is no guarantee of future results, as the saying goes; but given this long period of growth, it is no wonder that middle market leaders feel more confident about the economy than they ever have. It has been nearly a decade since they have faced headwinds from the economy. But while they are benefitting from good conditions, it is worth reflecting on some smart things middle market leaders are doing to make things even better for themselves and their companies. Although mid-size companies, especially those in the lower middle market, are susceptible to buffeting from economic conditions, we continue to see evidence of sound management bolstering performance.

They're investing in talent. Half of middle market leaders state talent is their company's number-one long-term challenge, and by an eight-to-one margin they say that labor market conditions will tighten over the next few months. The lower the number of people looking for jobs, the more important it is to train and retain the talent already in place. In 2015, just 26% of executives said they would increase their investment in workforce training and education. In 2016, that rose to 30%. This year, it jumped to 38%. During the same period, the number saying they would use wage increases as a retention tool is unchanged at 43%.

They're moving into new territories. Until 2017, the number of executives who said their company had expanded into a new domestic market in the previous year had never exceeded 33%. But in the four MMIs of 2017, those numbers were 36%, 38%, 36%, and 36%—a meaningful increase. As for international business, while the middle market remains overwhelmingly domestic (87% of sales come from the U.S.), those with international operations report strong expansion, with 45% reporting increased sales and just 4% reporting declines.

They're getting innovation to market. Middle market companies invest roughly 8% of revenue in R&D—a percentage that has remained consistent, though of course the absolute dollars increase as revenue does. There is a change at the other end of the R&D pipeline, however. This quarter, 41% of middle market executives say they expect the proportion of revenue from new products to increase next year, while 57% say it will stay the same and 2% that it will decline. But two years back, just 31% thought new products' share of revenue would increase, with 66% forecasting no change, and 3% a decline. Whatever the cause or causes might be, it is clear that the middle market is making more of its R&D investment than it did.

They're minding the store. MMI data contain little evidence that executives are letting their very high confidence in the economy translate into untoward exuberance in their behavior. The trend line for companies taking on new debt is as flat as Florida. Capital spending is up only a bit. More companies are holding increased inventory than were at this time a year ago--but more companies are also holding less inventory.

The overall picture is one we have seen before: Middle market companies move quickly when they see an opportunity, but not before they feel sure of it, and prefer to pay as they go. It is a formula that has produced economy-leading results for middle market companies, and seems likely to serve them well whatever the coming year brings.

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