NATIONAL CENTER FOR
THE MIDDLE MARKET

1Q 2016

MIDDLE MARKET INDICATOR

GROWTH STABILIZES; OUTLOOK IMPROVES

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

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U.S. MIDDLE MARKET DEFINED

ANNUAL REVENUE
RANGING FROM
$10MM – $1B

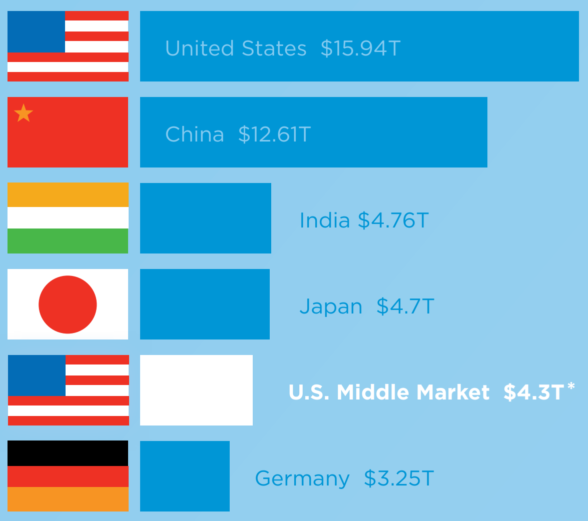
$ LOWER MIDDLE MARKET
$10MM - $50MM

$ $ 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

For the first quarter of 2016, year-over-year revenue growth is up in the middle market and employment growth remains stable, representing the end and possible reversal of the downward trajectory in growth rates that defined the middle market in 2015. While middle market revenue and employment both grew last year, consistently outpacing the growth of larger businesses and the S&P 500, the rate of that growth declined steadily over the course of 2015. Small businesses in particular experienced a slowdown in growth at the end of last year. That trend has stopped and appears to have reversed. For now, growth rates appear to have stabilized, though at slightly lower levels than experienced in 2014 and the first half of 2015. At the same time, confidence has returned after slipping last quarter, and the indications for the coming year suggest that the pace of growth may once again accelerate in the critical middle market segment.

The proportion of middle market companies reporting year-over-year performance improvements held steady since last quarter, with 58% of firms contending that business is better today than it was one year ago. Among small middle market companies (with revenues between $10 million and $50 million) the proportion of firms reporting improved year-over-year performance rose significantly to 60% from 51% at the end of 2015. More retail trade businesses reported improved performance this quarter; however, the number of healthcare firms saying business has improved since last year is down notably. Across core equities—including workforce issues, innovation, cost structure, customer acquisition, and operational excellence—middle market businesses mostly describe company performance as moderate to fairly good.

As with performance, the number of companies reporting year-over-year revenue increases has remained stable, with 69% of businesses reporting growth. Businesses are building their revenues primarily by growing their organizations; one in five firms has invested in additional advertising and marketing.

Across the middle market, revenue growth continues at a healthy rate of 6.3%, a slight uptick from the 6.1% growth rate recorded a quarter ago. The year-over-year growth rate among the smallest middle market businesses rebounded since dropping significantly last quarter. From an industry perspective, the business services and financial services sectors continue to post the highest revenue growth.

Approximately four in 10 middle market businesses report year-over-year increases in employment, the same percentage as at the start of 2015. Although employment growth rates declined gradually over the course of the past year, they have remained steady at 3.6% for the past six months. As with revenue, the smallest middle market companies rallied since last quarter, reporting a notable increase in year-over-year employment growth rates for Q1 2016.

The short-term business outlook, based on anticipated business climate, forecasted demand, and expected sales, is better than at any other time during the past year. While most middle market business leaders expect the business climate to remain unchanged in the short-term, one in five anticipate a more favorable environment. Almost half (46%) of middle market businesses, and especially small firms, expect sales to increase, and fewer firms expect an increase in costs in the next three months. Most companies foresee the size of the workforce holding steady.

Looking further into the future, companies, and especially smaller middle market businesses, forecast a significant increase in the rate of year-over-year revenue growth. The construction, financial services, and healthcare sectors are particularly optimistic about future growth. However, expectations for employment growth remain stable across all revenue segments. Most middle market companies believe their workforce is the right size for current market conditions, which will likely keep employment growth modest in the months to come.

Staffing issues, compliance with regulations, and competition will continue to be the strongest headwinds as middle market companies work to grow their businesses throughout 2016 and beyond.

REVENUE GROWTH
Growth stabilizes at a healthy rate

Following a year of fluctuations, revenue growth appears to be stabilizing at a strong but sustainable level. Nearly seven in 10 middle market firms report year-over-year increases in revenue with a mean total revenue growth rate of 6.3% for Q1 2016, up slightly since the end of last year. After declining in Q4 2015, revenue growth for the smallest middle market companies has rebounded. On the other end of the spectrum, the largest middle market firms have seen growth slow over the past six months.

Growth projections for the year ahead rebounded this quarter after plummeting in mid 2015. A slight majority of middle market firms anticipate future growth at a mean rate of 4.6%, up significantly from 3.7% expected last quarter. This number remains below the 5% - 6% growth projections made in 2014 and early 2015. However, it is worth noting that middle market companies consistently deliver results between one and two percentage points higher than their projections.

1Q'16 **69%** of middle market companies reported positive revenue growth. 1Q'15 70%

MIDDLE MARKET

PAST 12 MO.

1Q'16 6.3%

4Q'15 6.1% 1Q'15 7.4%

NEXT 12 MO.

1Q'16 4.6%

4Q'15 3.7% 1Q'15 5.3%

S&P 500

PAST 12 MO.

1Q'16 -3.4%*

4Q'15 -9.6% 1Q'15 2.9%

EMPLOYMENT GROWTH
Employment growth rates remain consistent

Year-over-year employment growth rates have been relatively stable since the end of 2014, averaging 3.6% for the past two quarters. Around four in 10 firms across all middle market revenue segments continue to say employment has increased over the past 12 months. Larger middle market firms experienced slightly higher rates of employment growth, and companies in the business services, financial services, and healthcare sectors grew their workforces at a more rapid rate (5%+) than their peers.

Just over one-third (34%) of businesses expect to add to the payroll in the year ahead. These companies continue to anticipate a modest employment growth rate of 2.7%, the same as in the 4th quarter of 2015. Organizations in the healthcare sector have more aggressive growth expectations and plan to increase employment by 4% over the next 12 months.

1Q'16 **34%** of middle market companies expect to add jobs. 1Q'15 39%

MIDDLE MARKET

PAST 12 MO.

1Q'16 3.6%

4Q'15 3.6% 1Q'15 4.3%

NEXT 12 MO.

1Q'16 2.7%

4Q'15 2.7% 1Q'15 3.2%

ADP [PAST 12 MO.]

LARGE CORP.

1Q'16 2.2%

4Q'15 2.0% 1Q'15 2.1%

SMALL BUS.

1Q'16 2.1%

4Q'15 2.2% 1Q'15 2.7%

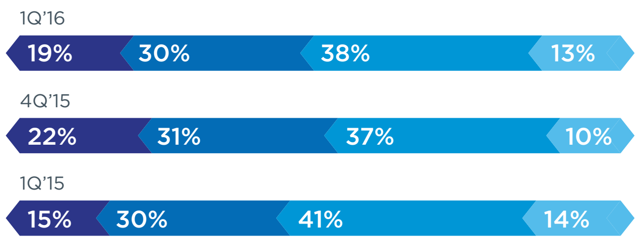
ECONOMIC CONFIDENCE

Confidence rebounds across the board

Middle market leaders' confidence in the global, national, and local economies cooled slightly at the end of last year. For Q1 2016, confidence returned to the higher levels seen in mid 2015. A majority of companies are confident in the global state of affairs, while almost three-quarters have a positive perspective of the national situation, and more than eight in 10 report confidence in their economies closest to home.

Positive perceptions of both major and emerging economies worldwide, along with a positive national employment outlook and strong local housing markets are bolstering confidence at all levels for most leaders. Those leaders who are not in the majority voice various concerns including the lack of a clear economic vision for the country and the lack of local policies that are conducive to running successful businesses. Only half of middle market leaders anticipate moderate growth for the U.S. economy in 2016, and slowing global economic growth is considered a serious threat to U.S. economic well-being.

GLOBAL ECONOMY



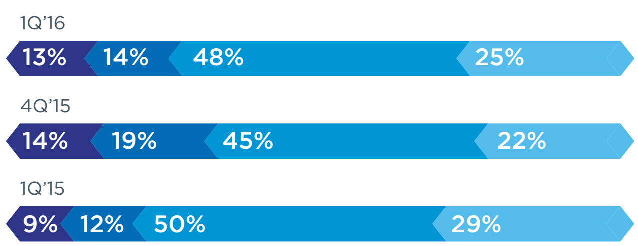
1Q'16

51%

CONFIDENT / SOMEWHAT CONFIDENT

4Q'15 47% 1Q'15 55%

NATIONAL ECONOMY



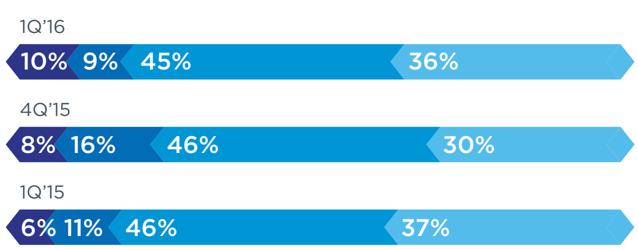
1Q'16

73%

CONFIDENT / SOMEWHAT CONFIDENT

4Q'15 67% 1Q'15 79%

LOCAL ECONOMY



1Q'16

81%

CONFIDENT / SOMEWHAT CONFIDENT

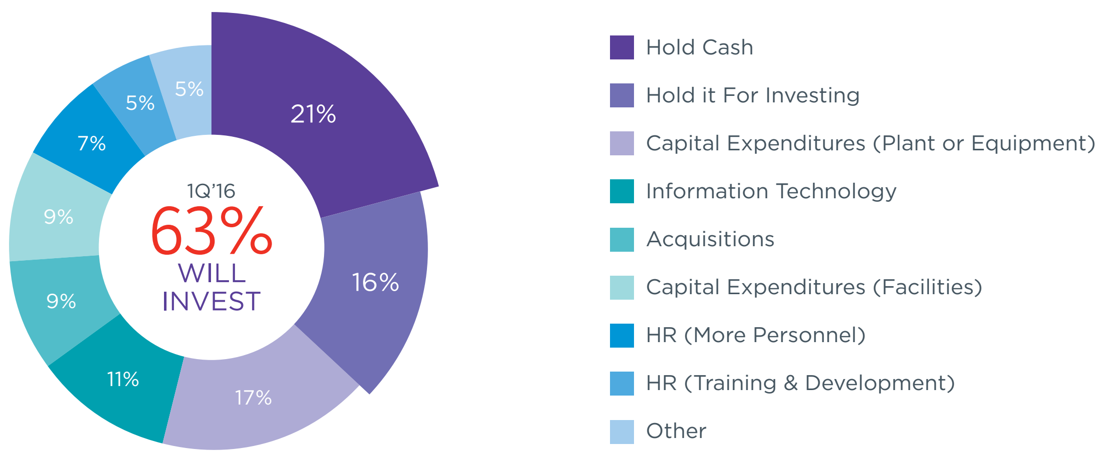
4Q'15 76% 1Q'15 83%

Not confident | Somewhat not confident | Somewhat confident | Confident

CAPITAL INVESTMENT
Most firms will invest

The proportion of middle market firms willing to invest extra cash as opposed to hold it has remained relatively consistent over the past three years. Quarter after quarter, around two-thirds of firms say they would invest extra dollars. That number rose to 68% at the end of 2014, then fell gradually throughout 2015. It appears stable at 63% today. Plans for expansion, however, remain relatively muted with about a third of firms planning to introduce a new product or service or expand into new domestic markets over the next 12 months. Core middle market companies are the exception: A slight majority of these companies say they plan to debut a new product or service this year.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES
Staffing concerns, compliance, and competition continue to challenge firms

Over the next three months, middle market businesses are most concerned with growing their companies and maintaining a skilled workforce while contending with economic uncertainty, government regulations, and rising competition. These challenges will continue to be the major issues throughout the year ahead, as they have been in the past.

In order to acquire and retain the talent they need to grow and expand, more than half (52%) of middle market firms are considering improving wages, representing a significant increase in the proportion of firms considering salary adjustments. In addition, significantly more firms are contemplating offering flexible work arrangements.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:	
1. BUSINESS	62%
2. STAFF/EMPLOYEES	51%
3. COSTS	22%
4. GOVERNMENT	9%
EXTERNAL CHALLENGES:	
1. BUSINESS	34%
2. GOVERNMENT	21%
3. COMPETITION	20%
4. ECONOMY	16%
5. COSTS	14%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:	
1. STAFF/EMPLOYEES	40%
2. BUSINESS	40%
3. COSTS	15%
4. GOVERNMENT	4%
EXTERNAL CHALLENGES:	
1. BUSINESS	26%
2. GOVERNMENT	20%
3. COMPETITION	14%
4. ECONOMY	14%
5. COSTS	13%

Perspectives

A RETURN TO OPTIMISM

As 2016 begins, the middle market has reversed a 2015 trend of slowly ebbing optimism and somewhat declining growth rates. After falling for four quarters, executives' confidence in the local and national economies turned decisively upward; indeed, confidence in local economies is at near-record levels. Even the global economy (generally regarded with the least favor by the middle market) looks better to executives than it did six months ago, though it remains a source of angst. Also looking good is an index of short-term sentiment that we have been compiling for the last four quarters. This combines next-three-months expectations for the business climate, demand, and sales; that number sank for nine months, but rebounded sharply this quarter. In particular, 68% of middle market leaders expect sales to increase in the next three months—the highest number we have seen. Just 1% foresee a decline.

This uptick follows a year in which growth and employment grew less robustly than they had the year earlier. But remember, even those muted 2015 numbers were the brass band leading the U.S. economy. The middle market's lower 4th quarter annual revenue growth rate, the lowest of 2015, was still 6.1%, vs. -3.4% for the S&P 500. The rate has now edged up to 6.3%. The middle market's employment growth, holding steady at 3.6%, handily outpaced job creation by companies small (2.1%) and large (2.2%). So the renewed strength in the middle bodes well for the economy as a whole.

One quarter may reverse a trend, but it does not establish a new one. It is too early to say that this economic expansion—now the third-longest in American history—has a second wind. But in the middle market at least, it is not gasping for breath. It is particularly interesting that the smallest middle market companies—those with sales between $10 and $50 million—reported the greatest rise in sales, employment, and confidence. These companies are sensitive to the economy, because their size puts them at the mercy of the economic weather, like small boats on choppy waters; but size also gives them the agility to react quickly to good news or bad.

STILL CAUTIOUS AFTER ALL THESE YEARS

For the year ahead, middle market companies project growth at an average rate of 4.6%—a significant jump from the 3.7% they predicted just three months ago. We have remarked before on the middle market's conservative forecasts—on average, companies grow 1.6 percentage points faster than their executives forecast. (The habit of understatement may stem from the fact that six out of seven middle market companies are private and are not trying to impress stock analysts.) If the pattern holds, we can look forward to above-six-percent revenue growth in 2016.

What investments will drive that growth? Not a burst of new products and services—those forecasts are holding steady and R&D budgets are actually down a bit, though companies in the core middle market (revenues between $50 and $100 million) say they will offer significantly more new products this year than last. Not an upsurge in acquisition activity—though, again, the core middle market foresees more deal-making. Nor an outpouring of marketing and advertising—those numbers look steady and conservative. Instead, executives are directing the largest portion of their investment toward building capacity, exploring new channels, and expanding business relationships both up- and downstream—blocking and tackling to get more out of the business they have. In the core middle market last year, 16% of companies added a new plant or facility—but 22% of these companies plan to do so in the next twelve months.

RAISES RISING?

Most companies say their workforce is about the right size, and three out of four companies expect the labor market to remain about as tight as it is today over the next few months; they expect to add workers at about the same pace this year as last. Clearly competition for talent has picked up as the U.S. economy continues to add jobs; in executives' long-term view, talent is the number-one challenge. This quarter saw a noteworthy change in what companies intend to do to get and keep talent. Offering higher salaries ranked first, as it has before; but the percentage citing salaries leapt from 43% to 52% compared to last quarter. That willingness to pay more showed up in the Labor Department's February and March jobs reports, too, and in some jurisdictions minimum wages are slated to rise. That is good news for employees, of course. And it appears that middle-market companies feel comfortable about it, because costs are under control overall. Twenty-nine percent say they expect their costs to increase, down from 36% last quarter, and fully 87% expect profit margins to stay the same or improve in the year ahead.

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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: Wholesale Banking, Consumer Banking and Private Wealth Management, and Mortgage. 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 December 31, 2015, SunTrust had total assets of $191 billion and total deposits of $150 billion. The company provides deposit, credit, trust, investment, mortgage, asset management, securities brokerage, and capital market services. SunTrust's Internet address is suntrust.com.

Grant Thornton

Founded in Chicago in 1924, Grant Thornton LLP (Grant Thornton) is the U.S. member firm of Grant Thornton International Ltd, one of the world's leading organizations of independent audit, tax and advisory firms. In the United States, Grant Thornton has revenue in excess of $1.3 billion and operates 57 offices with more than 500 partners and 6,000 employees. Grant Thornton works with a broad range of dynamic publicly and privately held companies, government agencies, financial institutions, and civic and religious organizations. "Grant Thornton" refers to Grant Thornton LLP, the U.S. member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. Please see grantthornton.com for further details.

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NATIONAL CENTER FOR
THE MIDDLE MARKET

2Q 2016

MIDDLE MARKET INDICATOR

GROWTH REBOUNDS; OUTLOOK REMAINS BRIGHT

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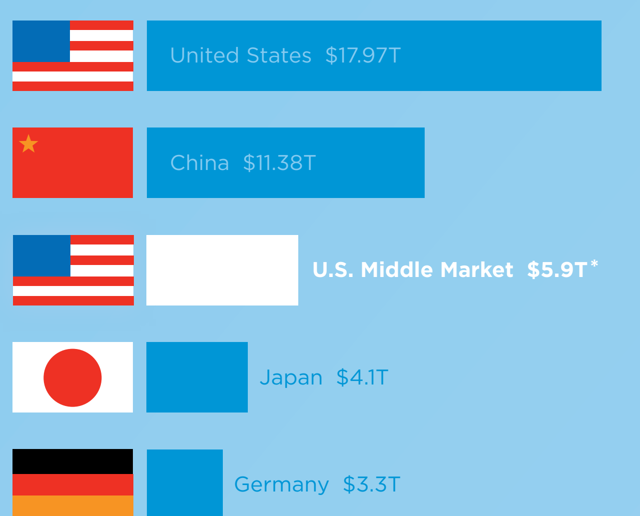


*Source: 2015 CIA World Fact Book (not adjusted for purchasing power parity), *National Center for the Middle Market (estimate)*

Executive Summary

For the second consecutive quarter, year-over-year revenue growth rates among middle market companies are up. Following suit, year-over-year employment growth rates increased for Q2 after remaining flat for the previous six months. The smallest middle market businesses have maintained the improvements reported last quarter while the largest companies are now showing signs of accelerating growth. Along with these performance improvements, middle market leaders report a healthier outlook for their businesses along with solid confidence in the economy as a whole. Although organizations continue to face staffing and growth challenges as well as election year uncertainty, middle market companies across all revenue segments appear poised to enjoy another period of robust growth.

Significantly more middle market businesses have seen improvements in their past year company performance this quarter than last. Nearly two-thirds of businesses (64%) say company performance improved over the past 12 months, compared to 58% of companies that reported the same last quarter. The largest middle market companies (with revenues between $100 million and $1 billion) show the most notable improvements in performance. On the other end of the revenue spectrum, the smallest middle market businesses (with revenues between $10 million and $50 million) have maintained the increases reported last quarter. Significantly more construction companies feel performance has improved, and performance has rebounded in the retail trade and healthcare industries, as well.

Looking at the income statement, nearly three-quarters (72%) of middle market firms say revenues increased over the past 12 months. Revenue growth averaged 7.2%, nearing the highs reported in late 2014 and early 2015. The current growth rate is well above the Middle Market Indicator historical average of 6.4%. Revenue growth is coming from both ends of the middle market size spectrum; with the largest middle market businesses reporting particularly strong increases in the rate of growth. To fuel the expansion, companies across the middle market are increasing sales, developing new product lines, and entering new markets. More than a quarter of companies have intensified their marketing efforts—a jump from what we saw last quarter.

At 4.4%, the rate of year-over-year employment growth increased for the first time in the past nine months. The current rate of growth exceeds the Middle Market Indicator's historical average of 3.2% and comes primarily from larger middle market businesses.

From an industry perspective, construction and retail trade report the greatest performance improvements. More businesses within these sectors are growing, and they are growing at a faster rate than reported three months ago. Construction businesses in particular are growing their revenues as well as the size of their workforces.

The short-term business outlook in the middle market improved noticeably last quarter and remains robust. While most companies continue to expect the business climate and demand to remain unchanged, fewer companies expect the situation to worsen. In fact, about two in 10 companies expect a more favorable business climate while fewer than one in 10 expect conditions to decline. A third anticipate an increase in demand and approximately four in 10 businesses expect to see an increase in sales in the short term. While middle market leaders see their revenues and payrolls increasing in the next three months, they do not currently appear worried about costs rising faster than they can manage them.

Expectations for 12-month revenue growth increased significantly last quarter and remain at those elevated levels today. Construction firms and service sector businesses especially anticipate a faster rate of growth in the year ahead. The vast majority of middle market companies continue to believe the workforce is appropriately sized. They forecast modest increases in employment in the next 12 months. Following cues from revenue growth, construction and service businesses anticipate the greatest hiring increases.

In addition to ongoing challenges related to staffing, competition, and regulations, middle market leaders express uncertainty over the upcoming U.S. presidential election and its impact on the business environment. Regulations and taxes remain key areas of concern.

REVENUE GROWTH
Revenue growth rates rebound

After two quarters in which revenue grew at about 6.1%, the growth rate climbed to 7.2% this quarter, mirroring the high levels of growth reported during the second half of 2014 and early 2015. More than seven in 10 companies report revenue growth gains since last year. Large middle market companies in particular report a rebound, with close to 80% experiencing revenue increases at a mean rate of 8.5%. From an industry perspective, construction shows the most notable revenue gains.

Revenue growth projections increased significantly in the first quarter of 2016, and those higher projections held steady this quarter as well. More than half of middle market companies across all revenue segments and industries expect revenue to increase in the year ahead. At 4.8%, the rate of anticipated growth is nearing levels reported one year ago after dropping significantly in Q3 2015.

2Q'16 **72%** of middle market companies reported positive revenue growth. 2Q'15 66%

MIDDLE MARKET

PAST 12 MO.

2Q'16 7.2%

1Q'16 6.3% 2Q'15 6.6%

NEXT 12 MO.

2Q'16 4.8%

1Q'16 4.6% 2Q'15 5.1%

S&P 500

PAST 12 MO.

2Q'16 1.2%*

1Q'16 -3.4% 2Q'15 -1.8%

EMPLOYMENT GROWTH
Employment growth is strong

While the percentage of middle market companies adding to their workforces has remained stable over the past year, mean total year-over-year employment growth is up this quarter to 4.4% compared to the 3.6% reported for the previous two quarters. The largest middle market firms have done the most hiring, with an average employment increase of 5.9%. Construction and manufacturing companies appear to be staffing up as well.

Expectations for future employment growth have improved. Close to four in 10 (37%) middle market firms expect to hire in the next 12 months; the average projected payroll growth is 3.3%, up from 2.7% reported the last two quarters. The largest middle market organizations and businesses in the service sector and construction sector are making the strongest growth projections for the year ahead.

2Q'16 **37%** of middle market companies expect to add jobs. 2Q'15 38%

MIDDLE MARKET

PAST 12 MO.

2Q'16 4.4%

1Q'16 3.6% 2Q'15 3.6%

NEXT 12 MO.

2Q'16 3.3%

1Q'16 2.7% 2Q'15 2.7%

ADP [PAST 12 MO.]

LARGE CORP.

2Q'16 2.3%

1Q'16 2.2% 2Q'15 1.7%

SMALL BUS.

2Q'16 1.9%

1Q'16 2.1% 2Q'15 2.7%

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

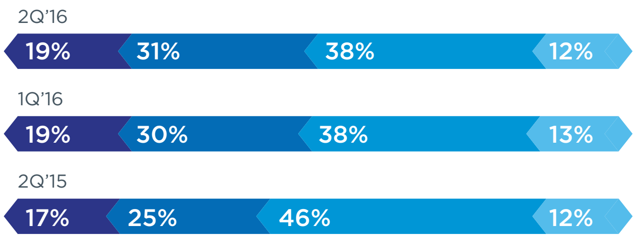
ECONOMIC CONFIDENCE

Confidence dips slightly

Since experiencing an uptick at the beginning of 2016, confidence in the national, state, and local economies remains relatively stable. However, the confidence levels may have peaked. As has been the trend, local confidence rates are the highest at 79% (compared to 81% last quarter). National confidence lags somewhat behind at 69% (versus 73% for Q1 2016). The global perspective continues to be the least bright, with just half of middle market leaders expressing a positive view of the global situation, down one percentage point from 51% last quarter. The UK's Brexit vote is likely to reduce that number further in the months ahead. (See Perspectives, p. 7.)

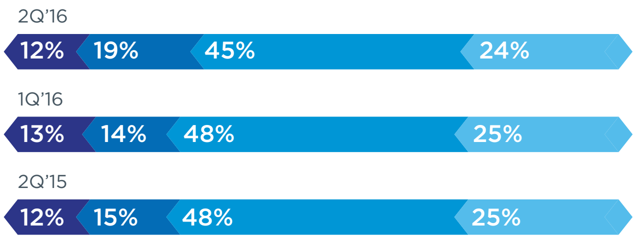
At the local and state levels, new business and employment growth and an increase in housing startups fuel confidence. For many middle market leaders, technological advancements coupled with strong worldwide demand for products and services paint a positive picture for the global economy. However, global unrest, uncertainty over the upcoming U.S. presidential election, and regulations at every level of government appear to somewhat temper confidence across the board.

GLOBAL ECONOMY



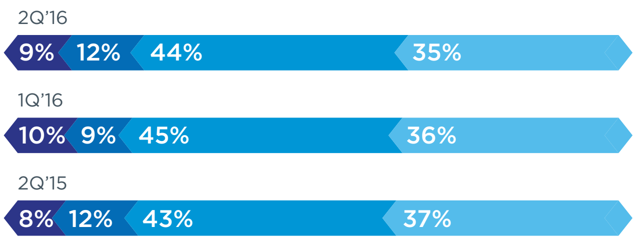
2Q'16
50%
CONFIDENT / SOMEWHAT CONFIDENT
1Q'16 51% 2Q'15 58%

NATIONAL ECONOMY



2Q'16
69%
CONFIDENT / SOMEWHAT CONFIDENT
1Q'16 73% 2Q'15 73%

LOCAL ECONOMY



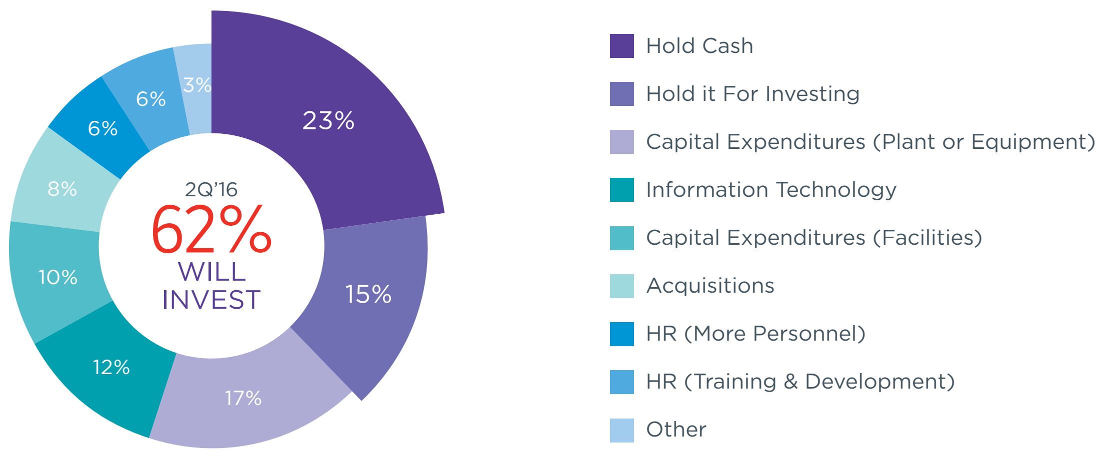
2Q'16
79%
CONFIDENT / SOMEWHAT CONFIDENT
1Q'16 81% 2Q'15 80%

Not confident · Somewhat not confident · Somewhat confident · Confident

CAPITAL INVESTMENT
Investment plans are restrained

The middle market's appetite for investment has not fluctuated much over the past four and a half years. Asked what they would do with an extra dollar of profit, a majority of businesses—currently 62%—express a desire to invest the money while fewer than four in 10 firms (38%) prefer to hold onto it as cash. This is at the low end of the historical range. For the most part, plans for expansion remain stable. Almost a quarter (24%) of companies are considering new plant or facility additions in the next 12 months, while 39% expect to expand domestically and 42% say they will introduce a new product or service. After jumping significantly last quarter, the proportion of core middle market businesses planning on launching new offerings has returned to around a third. As noted earlier, marketing spending appears to be trending upward.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES
Election year uncertainty joins the list of top challenges

Middle market organizations continue to contend with hiring and retaining qualified employees, business growth, development issues, and how to keep pace with their competitors. In the short term, companies worry about health insurance and transportation costs. Looking further out, the ability to sustain competitiveness, find new customers, and successfully introduce new products remain key concerns. On top of these ongoing challenges, political uncertainty, given the election year, will be an issue both short and long term. The outcome of the election and its impact on policies and taxes is, not surprisingly, top of mind for many middle market business leaders today.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	63%
2. STAFF/EMPLOYEES	51%
3. COSTS	23%
4. GOVERNMENT	13%

EXTERNAL CHALLENGES:

1. BUSINESS	35%
2. GOVERNMENT	23%
3. COMPETITION	19%
4. ECONOMY	15%
5. COSTS	14%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. STAFF/EMPLOYEES	41%
2. BUSINESS	39%
3. COSTS	18%
4. GOVERNMENT	6%

EXTERNAL CHALLENGES:

1. BUSINESS	26%
2. GOVERNMENT	18%
3. COMPETITION	14%
4. ECONOMY	13%
5. COSTS	13%

Perspectives

GROWING AND GROWING AND GROWING

Seven full years into the economic expansion that began in July 2009, the middle market has been picking up the pace when one might expect it to be gasping for breath. Middle market revenues and payrolls grew faster in the second quarter of 2016 than in the first—spiking nearly a full percentage point on the top line, and 0.8% for payrolls. Both revenue and payroll growth are higher than they were in the second quarter a year ago. And, though executives' forecasts of future growth lag last year's, they have risen for four quarters in a row, a trend of rising expectations that we have seen only once before in the MMI's history (starting in the third quarter of 2012).

Growth was fastest among the larger middle market companies (annual revenues between $100 million and $1 billion), whose sales increased 8.5% on average in the last 12 months. For the last two years, this has been the norm: In all but two of those eight quarters, the larger segment of the middle market has outpaced companies in the core ($50-100 million) or smaller ($10-50 million) segments—though it is worth noting that smaller firms project faster growth than their larger cousins do.

At the halfway point of the year, 2016 is shaping up well. Confidence in global, national, and local economies has dipped a tad, but only 8% of middle market executives expect the business climate to worsen, while 19% expect it to improve. The ratio of optimists to pessimists is currently 2.4 to one—the highest in over a year.. Among companies that expect to grow, the mean anticipated revenue increase is an impressive 10.8%.

Now, these data were collected in the first half of June, before Great Britain's shock vote to leave the European Union. We returned to our surveyed companies a week after the Brexit vote to ask about it. Forty-nine percent say Brexit will have at least a somewhat significant impact, and 13%—one in eight—say it will be extremely significant. Investments in the UK will be hit—28% of middle market companies say those will decline, and 21% say they will reduce investments to the rest of the EU. Instead, 26% say, they will redirect investments home to the U.S.

LEVERS OF GROWTH AND PERFORMANCE

When a company outperforms its industry or the economy, its leaders must be doing something right. Using factor and regression analyses, we have ranked activities that appear to have the greatest leverage on top-line growth. Foremost is expanding into new markets (especially domestic), which contributes 43% to middle market company growth. Innovation comes second, contributing 29%. Talent investments are third, with an 11% contribution. These are not mutually exclusive; CEOs know and our studies document that lack of talent is a major obstacle to global expansion, for example.[1]

Growth is an important element of overall performance, but the full value of an enterprise also depends on its competitive position, efficiency, profitability, risk management, and other factors. Accordingly, the gearbox that drives overall performance is different. For example, salesforce effectiveness and retaining profitable customers rank high as levers of performance, whereas market expansion and finding new customers matter more for revenue. There is a strong link between planning and both growth and performance, but for overall performance the emphasis is on strategy and long-term plans.

TOP DRIVERS OF GROWTH	TOP DRIVERS OF OVERALL PERFORMANCE
Expansion into new domestic markets	Overall salesforce effectiveness
Percentage of annual revenue spent on R&D	Having a long-term, 3-5 year growth strategy in place
Attracting new customers	Retaining profitable accounts
Setting formal annual growth targets	Maintaining margins
Overall salesforce effectiveness	Innovating new products and services

PUBLIC SERVICES

Former Illinois governor Adlai Stevenson famously quipped, "Your public servants serve you right." This quarter we asked a set of questions to elicit how government services help, hold, or hinder middle market companies, at federal, state, and local levels.

The headline: local governments do pretty well in executives' estimation, whether in basic services like infrastructure and policing, regulations and incentives, or value-added services like trade promotion or workforce training. States are viewed less favorably, and the federal government trails for everything from infrastructure to taxes. A few federal programs score high, especially energy efficiency and Commerce Department programs. Unsurprisingly, satisfaction varies greatly by industry, state, and region.[2] Overall, the regulatory burden is not egregious: 35% say it is just right, 51% say it is high but manageable, and just 13% say it is unmanageably high.

System complexity appears to hurt middle market companies. Big enough to operate across boundaries but lean in their compliance staffing and expertise, they struggle with overlapping taxes and rules. Asked if they could choose either tax reduction or tax simplification, but not both, they pick simplification, 50% to 42%. (Eight percent don't have a problem either way.) Nearly a third (31%) say regulatory overlap creates major hurdles to getting work done.

[1] See NCMM and the Brookings Metropolitan Policy Program, *Accelerating Exports in the Middle Market: Global Opportunities for U.S. Firms and Metro Areas,* 2014. [2] For more detailed government-satisfaction data, see: *Middle Market Perspectives on Government Services,* 2016 URL TO COME

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.

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NATIONAL CENTER FOR
THE MIDDLE MARKET

3Q 2016

MIDDLE MARKET INDICATOR

GROWTH CONTINUES; OUTLOOK IMPROVES

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

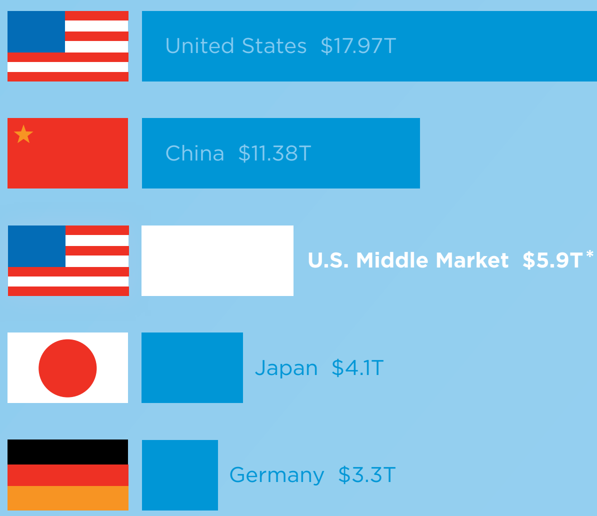
$ LOWER MIDDLE MARKET
$10MM - $50MM

$ $ 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 rate of revenue growth in the middle market remains strong, and employment growth rates continue to accelerate across middle market revenue segments and industries. What's more, executives' projections for future revenue and employment growth rates have climbed higher, with the outlook for employment at an all-time high since the inception of the MMI. Most middle market leaders express confidence in the state of the economy. But they worry about the impact of other external factors on growth, including government regulations and the pressure of competition. Internally, companies worry about recruiting and retaining the talent they will need to meet market conditions, drive innovation, and help their organizations continue to thrive.

Six in 10 middle market leaders say company performance has improved since one year ago, while just 6% indicate that performance has deteriorated—a ten-to-one ratio that has been fairly consistent over the last two years. Middle market companies say their performance is strongest when it comes to maintaining banking relationships, retaining profitable accounts, and being industry leaders. They also do quite well at maintaining high-performing management teams, keeping talented employees, controlling costs, and accessing capital at an affordable cost. They perform moderately well on metrics associated with customer acquisition, innovation, and operational excellence. The largest middle market companies, with revenues between $100M and $1B tend to rate their performance in all these core capabilities more favorability than their smaller peers.

Year-over-year revenue growth in the middle market remains healthy overall, with innovation being a driving factor. Some 43% of middle market businesses introduced a new product or service in the past year, and nearly one-quarter of firms derive 20% or more of their revenue from recently introduced products. However, fewer firms reported year-over-year revenue increases this quarter than last, and the rate of year-over-year revenue growth slipped from 7.2% to 6.3%. The largest middle market companies as well as companies in the manufacturing, wholesale, and retail trade sectors contributed to the overall revenue slowdown; growth in other industry segments accelerated compared to the second quarter.

While this quarter's revenue growth rate is almost exactly at the historic average of 6.4%, the employment growth rate has been trending higher each quarter for the last year. For Q3 2016, the rate of employment growth rose across all middle market revenue segments and nearly every industry, continuing its long-term trend of acceleration. Many of these businesses rely on their new hires to help drive innovation, which in turn helps drive revenue growth. Although the employment growth rate increased overall, the number of companies saying they increased the size of their workforces was just over 40%, a percentage that has been consistent over the past year.

Honing in on industries, construction continues to report substantial increases in both revenue and employment growth. The service, financial services, and healthcare industries are also showing notable gains in both areas. The manufacturing industry is the only industry segment to report a slowdown in the rate of employment growth, and revenue growth rates have slipped in manufacturing as well.

Going forward, just over 40% of middle market companies expect an increase in short-term sales. However, most companies expect demand to remain the same and the business climate to remain unchanged. The largest middle market companies are a bit more optimistic in their short-term outlook. Nearly half (46%) anticipate a boost in sales, while 27% expect the business climate to become more favorable. Across the middle market, approximately one-third of firms plan on increasing their workforce in the short term.

Looking further ahead, the outlook is decidedly positive for the next 12 months. The middle market is expecting both revenues and payrolls to grow at a faster clip. In particular, expectations for future employment growth rates are at an all-time high. Middle market businesses also anticipate in an increase in merger and acquisition activity over the next 12 months, which they believe will help create efficiencies through industry consolidation.

With employment on the rise, companies continue to struggle with attracting and retaining the people they need to drive innovation and performance. About one-quarter of firms expect a tighter job market in the short term as companies continue to hire. As businesses prepare to compete for top talent, they look to improve salaries and offer flexible work arrangements to attract the best employees.

Beyond talent concerns, additional headwinds that could impede growth include government regulations, increasing competition, and costs.

REVENUE GROWTH
Revenue growth rates hover around the long-term average

Middle market revenue growth remains healthy with most companies saying it has increased since last year. However, after spiking to 7.2% last quarter, the rate of growth settled back to 6.3% and is currently in line with the long-term average growth rate. The largest middle market companies, which have been driving growth rates for the past year, reported a sharp decline this quarter, from 8.5% to 6.0%. Manufacturing, wholesale, and retail trade companies also reported decreases in their rates of year-over-year revenue growth.

Despite this slowdown, projections for future growth continue to inch up and expectations are at the highest levels since mid-2015. Half of middle market firms anticipate increases in revenues in the year ahead, while only 5% forecast a decline. Middle market leaders at smaller firms express the greatest optimism for the next 12 months. Likewise, services, manufacturing, and healthcare companies have particularly positive expectations.

3Q'16 **63%** of middle market companies reported positive revenue growth. 3Q'15 71%

MIDDLE MARKET

PAST 12 MO.

3Q'16 **6.3%**

2Q'16 7.2% 3Q'15 7.2%

NEXT 12 MO.

3Q'16 **4.9%**

2Q'16 4.8% 3Q'15 4.1%

S&P 500

PAST 12 MO.

3Q'16 **2.5%***

2Q'16 1.2% 3Q'15 -6.2%

EMPLOYMENT GROWTH
Employment growth accelerates

About four in 10 companies report increases in year-over-year employment. At 4.9%, the rate of employment growth is near the MMI's all-time reported high and is well above the long-term average growth rate of 3.3%. Companies at both ends of the middle market revenue spectrum, and the largest middle market businesses in particular, are driving the acceleration. What's more, every industry, with the exception of manufacturing, is currently adding workers at a faster rate than one year ago.

At 4.0%, expectations for future employment growth are the highest ever reported by the MMI, although the number of companies saying they will increase employment is down slightly. The largest middle market firms are most optimistic. About a quarter of large firms believe their existing workforce is insufficient for meeting market conditions, and some 40% plan to increase employment by an average of 5% in the year ahead.

3Q'16 **37%** of middle market companies expect to add jobs. 3Q'15 42%

MIDDLE MARKET

PAST 12 MO.

3Q'16 **4.9%**

2Q'16 4.4% 3Q'15 4.1%

NEXT 12 MO.

3Q'16 **4.0%**

2Q'16 3.3% 3Q'15 3.2%

ADP [PAST 12 MO.]

LARGE CORP.

3Q'16 **2.3%**

2Q'16 2.3% 3Q'15 1.7%

SMALL BUS.

3Q'16 **1.8%**

2Q'16 1.9% 3Q'15 2.4%

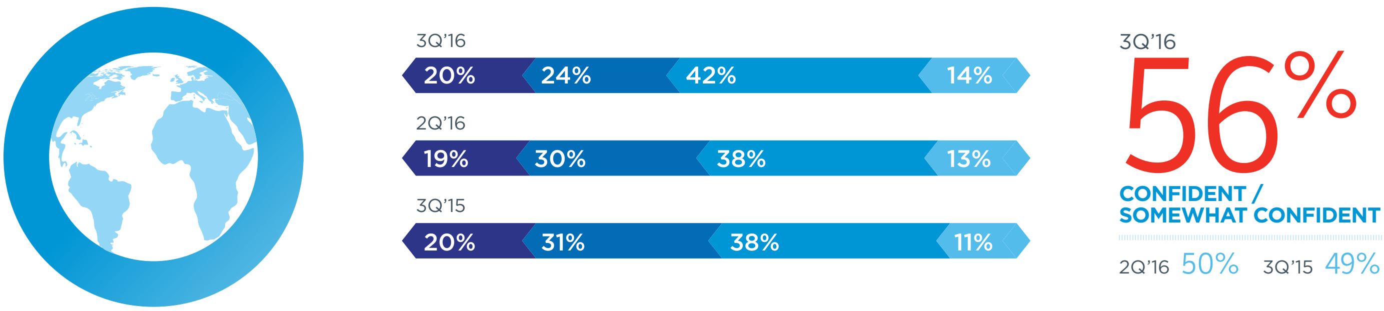
**3Q numbers include only companies who have reported 3Q earnings results. Numbers change as more businesses report financial results.*

ECONOMIC CONFIDENCE
Global confidence recovers

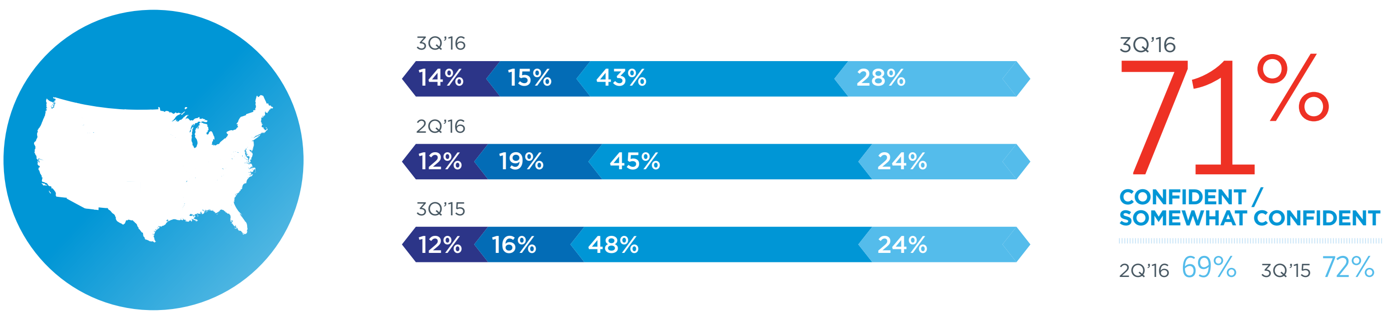
For the past year and a half, middle market leaders' confidence in their local and national economies has been relatively stable with a large majority of leaders expressing positive opinions on the state of affairs in their immediate area and throughout the country. This quarter, eight in 10 companies are satisfied with economic conditions closest to home. Nearly three quarters (72%) of businesses have a positive outlook regarding the national economy.

Since plunging in mid-2015, confidence in the global economy appears to be recovering and is nearing the highest levels reported by the MMI. As always, global confidence lags behind local and national confidence. However, this quarter, a majority of middle market leaders report a comfort level with current economic conditions around the world. In fact, despite Brexit, weak growth in China, and other sources of global disquiet, confidence in the global economy jumped from 50% last quarter to 56% today.

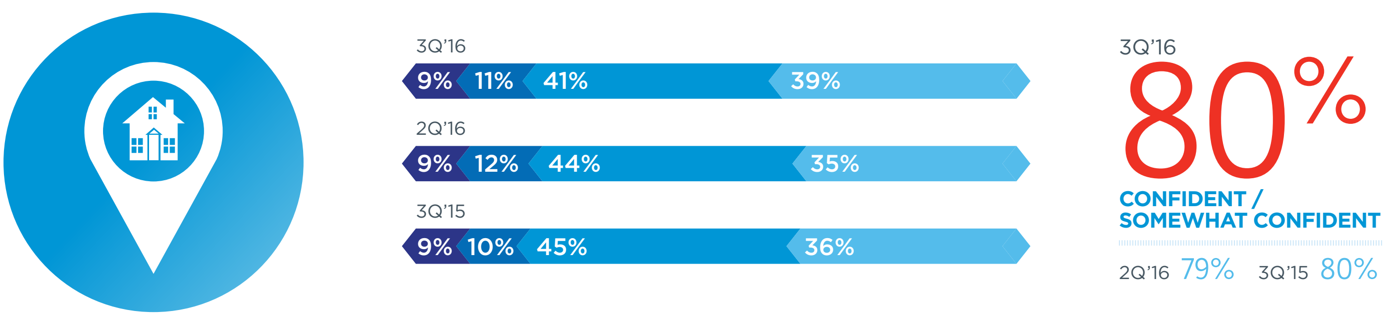
GLOBAL ECONOMY



NATIONAL ECONOMY



LOCAL ECONOMY



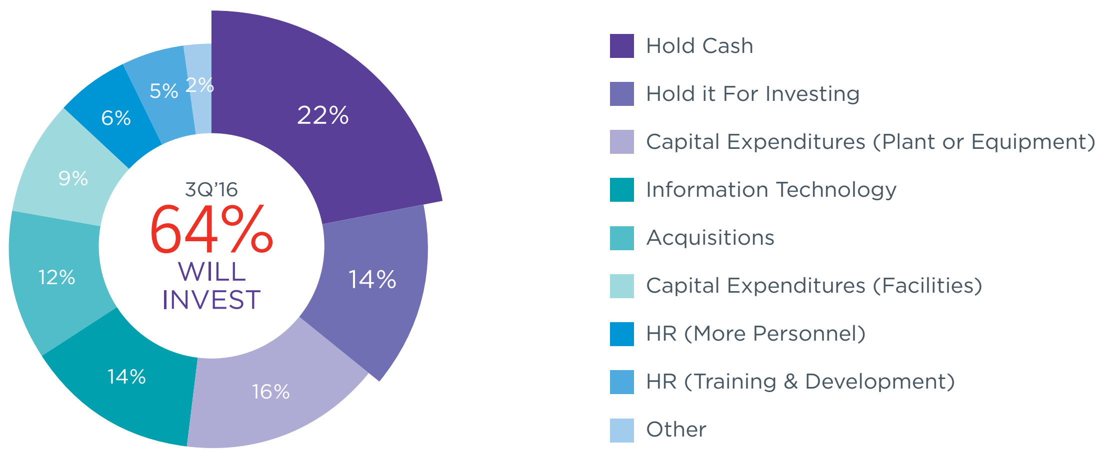
Not confident | Somewhat not confident | Somewhat confident | Confident

CAPITAL INVESTMENT

Appetite for investment stays strong

Approximately two-thirds of middle market companies continue to report that they would invest extra dollars, while a third of businesses prefer to save their money. Core middle market businesses are the most likely to hold on to cash while the largest mid-sized firms are the most likely to invest it. Most of the savers prefer to hold more cash; however 14% of companies say they would stow it away for future financial investments. Investment appetites would shrink if interest rates rise. Twenty-nine percent say they would be likely to reduce capital investment, 28% would slow down hiring, and 25% would increase cash reserves.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Core business issues remain the largest hurdle to growth

The greatest challenges for middle market leaders continue to revolve around core business issues, including finding new customers, expanding the business, and innovation. Talent management remains a key concern, especially as more middle market businesses are looking to grow at faster rates. A significant number of businesses also cite costs, especially healthcare costs, as an obstacle. From an external perspective, government regulations have a negative impact on two-thirds of middle market firms. Increasing competition continues to be a key hurdle as well. Companies rely on innovation to tackle some of these key challenges, and many focus on attracting and retaining innovative people.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	56%
2. STAFF/EMPLOYEES	46%
3. COSTS	16%
4. GOVERNMENT	10%

EXTERNAL CHALLENGES:

1. BUSINESS	35%
2. COMPETITION	20%
3. GOVERNMENT	19%
4. ECONOMY	12%
5. COSTS	12%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. STAFF/EMPLOYEES	43%
2. BUSINESS	40%
3. COSTS	12%
4. GOVERNMENT	4%

EXTERNAL CHALLENGES:

1. BUSINESS	29%
2. GOVERNMENT	17%
3. COMPETITION	16%
4. ECONOMY	11%
5. COSTS	11%

Perspectives

THE HUMAN SIDE OF GROWTH

Every quarter of continued strong performance by the middle market—and this was another one—raises the question, how long can this keep going on? Annualized revenue growth in the third quarter of 2016 was 6.3%. That is well below the 7.2% rate recorded three months ago, but is the same as the first quarter's growth, within the range we have observed over the last year and a half, and a good number however you look at it. Middle Market Indicator revenue growth rates jump around (and are not seasonally adjusted) but the overall trend is stable. This is the nineteenth Middle Market Indicator—just under five years of data—and during this time revenue growth has averaged 6.4%.

Though the overall rate was down in the third quarter, growth accelerated in the majority of industries, slowing only in wholesale and retail trade and, to a lesser degree, manufacturing. In terms of company size, this quarter's entire dip in revenue growth can be laid at the feet of larger middle market companies (with revenues between $100 million and $1 billion); topline growth among this segment fell from 8.5% to 6%. This is an exception to the usual pattern, in which larger companies outperform the others. Notably, however, the larger companies' growth forecasts are up slightly from three months ago.

There are cautionary notes in the tune played by a number of forward-looking numbers. Eight percent of middle market company leaders expect sales to decrease, up from 5% last quarter, while 41% expect sales to increase, which is down a tick. There is a similar tightening in the spread between executives who expect demand to fall vs. rise and between executives who expect the overall business climate to deteriorate vs. improve. An index of those three prognostications—sales, demand, and business climate—has fallen for two quarters in a row.

Still, executives' confidence in the global economy has risen from 49% to 56% in the last four quarters, and confidence in national and local economies is high (72%, 80%) and unchanged since the third quarter of 2015. At the firm level, companies expect their own profits to increase by 3.1% in the next twelve months, while costs rise just 2.1%. Interest-rate increases could raise costs, of course, trimming profit margins.

PAYROLLS EXPAND

Company-level confidence and profitability may explain some of the big jump in employment shown in this MMI. Revenue and payroll growth usually run in parallel, but this quarter job growth rose from 4.4% to 4.9% while top-line growth fell from 7.2% to 6.3%. Three quarters of the new jobs are full-time, and just two percent are reported to be temporary or seasonal.

The rate of hiring has been picking up for a year now—it is up from 3.6% four quarters ago. Is this a case of the middle market playing catch-up, finally acceding to demand by opening its doors to more staff? Is it a trend that will continue? We don't know, but for the moment it's good news for workers.

To explain the increase it helps to look at which industries added workers fastest. Construction was the star, with 8.5% payroll growth (and 10.5% revenue growth), followed by services (6.5% payroll increase, 9.0% revenue) and healthcare (6.1% and 8.1% revenue). All three industries are relatively automation-resistant (so far, at least), so that the labor content of a dollar of revenue shrinks less quickly than in manufacturing or even in retail, where store-level staffing levels have been falling.

What are these new employees doing? Sixty-three percent of companies say they have added jobs in operations, 51% in marketing and sales, and 36% in IT—that is, these are mostly revenue-generating jobs, though presumably many of the IT jobs are in data processing or cybersecurity.

CREATIVE BRAINS, WELL-OILED MACHINES

Some not-insignificant number of new employees are inventing the future. Math we did last quarter shows that middle market companies' growth is driven by investing in market expansion, innovation, and talent, in that order.[1] But, we noted, these are not mutually exclusive: Talent investments are a necessary element of both of the other initiatives. In fact, we learned this quarter, talent is the #1 lever for innovation. Asked how they make innovation happen, 54% of executives say that they hire new talent, 39% increase R&D, and 19% make acquisitions. (Twenty-one percent say they do none of these. Perhaps they innovate by rubbing a lamp.)

Company size leads to some interesting differences in emphasis. Asked which capabilities are most critical for innovation, everybody agrees that Job One is to attract and retain innovative people. But that is ranked most important in the core middle market ($50-100 million), where 70% say it is critical, vs. 60% overall. The bigger companies, with revenues between $100 million and $1 billion, place more of a premium on understanding customers and markets (65%, vs. 59% overall), want to take more risk (38% to 31%), and emphasize the importance of having structured processes to manage a pipeline of innovations (again, 38% to 31%). We've seen something like that before: As companies grow, they necessarily place more emphasis on process. The trick is to add structure without becoming restricted.

[1] Perspectives, 2Q 2016 Middle Market Indicator, p. 7

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NATIONAL CENTER FOR
THE MIDDLE MARKET

4Q 2016

MIDDLE MARKET INDICATOR

EMPLOYMENT PEAKS, CONFIDENCE SURGES

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

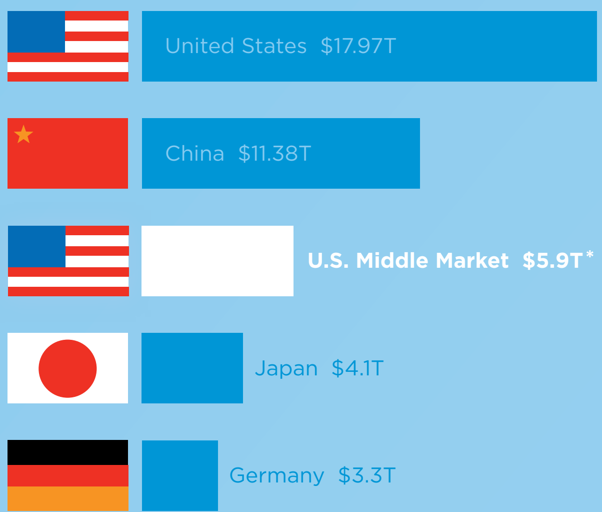
$ LOWER MIDDLE MARKET
$10MM - $50MM

$ $ 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 middle market ended a strong year on a strong note with year-over-year revenue growth rates above the five-year average and employment growth rates at an all-time high since the inception of the Middle Market Indicator five years ago. Companies report the highest economic confidence levels to date and most businesses remain willing to invest. Business leaders look forward to a prosperous 2017, with the majority expecting revenue growth to continue its upward trend. However, employment growth rates are expected to moderate somewhat, especially as companies continue to struggle with talent management issues including recruiting and retention. Other anticipated headwinds include challenges maintaining growth and managing capital as well as government rules and regulations.

Most companies (61%) continue to say that overall firm performance has improved since a year ago, up from 57% at the end of 2015. Fewer than one in 10 companies report deteriorating conditions. Companies believe they perform the best in areas such as maintaining banking relationships, retaining profitable customer accounts, being a leader in their industries, and managing cash flow. They see room for improvement when it comes to innovation, workforce issues, and managing healthcare costs.

Year-over-year revenue growth is up to 6.9% from 6.3% last quarter, with a higher percentage of companies reporting revenue increases. The largest middle market businesses (with revenues between $100 million and $1 billion), in particular enjoyed a successful year, with close to eight in 10 (78%) of these firms reporting revenue growth at a mean total growth rate of 8.1%. Forty-eight percent of middle market companies grew through expansion into a new market in 2016, with 32% entering a new domestic market and 16% entering a new international market. Four in 10 companies introduced a new product or service this year, and those new offerings accounted for more than 20% of revenues for about a quarter of middle market businesses, making innovation a crucial factor in growth. Few middle market companies view using debt to fund growth, and just 12% of companies took on new debt or opened a new line of credit in 2016.

As has been the trend all year, businesses once again report an increase in year-over-year employment growth. At 5.4% for Q4 2016, employment growth rates are at the highest level since the MMI began measuring and reporting growth rates in 2012. Middle market companies contend that hiring new talent is critical to innovation. Overall, 44% of middle market organizations increased employment in 2016, with just over half (51%) of the largest middle market firms increasing staff size.

After a year of building up the workforce, the vast majority of businesses (82%) believe the size of their current staffs is just about right.

While mid-sized businesses in all industries performed well this year, companies in the services and construction industries report the most positive year-over-year revenue and employment growth for 2016. In the service industry, both revenue and employment growth are at their highest reported rates, with 80% of service firms saying year-over-year revenues increased this quarter and 54% saying the workforce has expanded since last year. Similarly, construction companies posted their best numbers in Q4 2016 following a year of acceleration. With year-over-year revenue growth of 12.6% and employment growth of 9.3%, construction firms boast the highest numbers in the middle market.

The short-term outlook among middle market business leaders is the best it has been in two years, especially among the largest middle market companies. A greater percentage of firms expect both sales and demand to increase in the next three months, and more than a quarter (28%) of companies anticipate a more favorable business climate by the end of next quarter. About three in 10 (29%) companies plan to increase their workforce in the short term.

For the full year ahead, middle market companies will continue to be the lifeblood of the U.S. economy. Companies continue to anticipate increases in revenue growth. More than four in 10 firms expect to introduce a new product or service and/or expand into new domestics markets in 2017. They also expect profit margins to increase slightly while costs remain stable, and more than one-third of businesses intend to increase their prices over the next 12 months.

From an employment perspective, businesses say hiring will continue to increase. However, the projected rate of employment growth is down slightly from last quarter's forecast, except among the largest middle market companies. About one-quarter of executives expect a tighter job market as firms continue to compete for and onboard new employees, and they believe talent issues will remain a key challenge in the year ahead.

Additionally, regulations continue to have a negative impact on company performance for the majority of middle market businesses. Business leaders say costs will also be an issue in 2017, particularly healthcare costs, and energy costs to a lesser extent.

REVENUE GROWTH
Revenue growth rebounds and will continue to rise

Year-over-year revenue growth fluctuated in 2016, but companies ended the year reporting a growth rate of 6.9%, an increase from last quarter and slightly above the five-year average rate of 6.5%. Overall, more middle market companies reported year-over-year revenue increases this quarter compared to Q3. Businesses with revenue of $50M or more drove the increases while the rate of growth among the smallest middle market firms (with revenues between $10 million and $50 million), dipped slightly.

While actual growth rates have seesawed this year, projections for future growth have risen each quarter and are now at the highest levels seen in two years. Over half (56%) of middle market firms say gross revenue will increase at an expected rate of 5.5% in 2017. Based on the average understatement of projected growth compared to actual growth, revenue growth by the end of next year could reach a rate of 7.1%.

4Q'16 **70%** of middle market companies reported positive revenue growth. 4Q'15 69%

MIDDLE MARKET

PAST 12 MO.
4Q'16
6.9%
3Q'16 6.3% 4Q'15 6.1%

NEXT 12 MO.
4Q'16
5.5%
3Q'16 4.9% 4Q'15 3.7%

S&P 500

PAST 12 MO.
4Q'16
4.4%*
3Q'16 2.5% 4Q'15 -9.6%

EMPLOYMENT GROWTH
Employment growth peaks, but may taper off

More than four in 10 companies (44%) say employment increased in 2016, while just 12% report a decrease in headcount. Those businesses that hired have added jobs at increasingly faster rates. At 5.4%, the year-over-year employment growth for Q4 2016 is at the highest level since the inception of the MMI five years ago. In fact, throughout 2016, year-over-year growth rates escalated each quarter, and they have remained above the five-year historical average of 3.4% all year long.

For 2017, companies expect the rate of employment growth to moderate somewhat. A third of companies say they will add jobs at a rate of 3.4% over the next 12 months, a decrease from the 4.0% projected last quarter. Businesses will primarily add full-time positions with an emphasis on operations, marketing, and sales jobs. The largest middle market firms expect to add jobs in IT, also.

4Q'16 **33%** of middle market companies expect to add jobs. 4Q'15 32%

MIDDLE MARKET

PAST 12 MO.
4Q'16
5.4%
3Q'16 4.9% 4Q'15 3.6%

NEXT 12 MO.
4Q'16
3.4%
3Q'16 4.0% 4Q'15 2.7%

ADP [PAST 12 MO.]

LARGE CORP.
4Q'16
2.4%
3Q'16 2.3% 4Q'15 2.0%

SMALL BUS.
4Q'16
1.4%
3Q'16 1.8% 4Q'15 2.2%

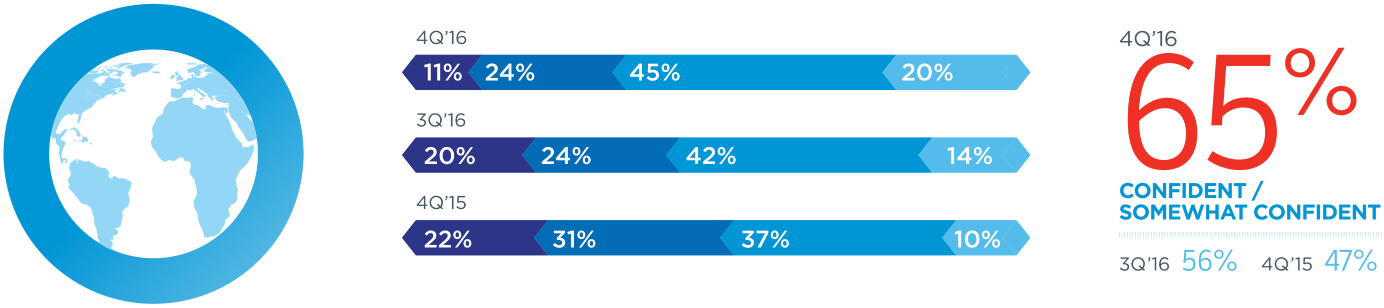
**4Q numbers include only companies who have reported 4Q earnings results. Numbers change as more businesses report financial results.*

ECONOMIC CONFIDENCE
Confidence soars

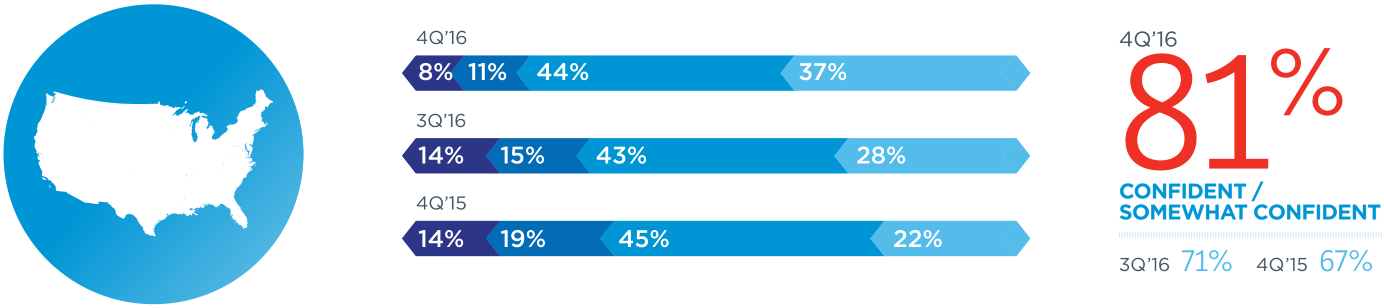
Measured just weeks after the 2016 U.S. presidential election, confidence levels in the global, national, and local economies is at the highest levels recorded by the MMI. Confidence has been trending up since Q2 2016 with more than eight in 10 companies reporting positive perceptions of their U.S. and metro area economies at the close of the year. A solid majority (65%) also say they are satisfied with the global state of affairs, representing a significant 18-point jump in global economic confidence since the end of 2015.

Companies with the fastest rates of growth are moving the needle on confidence. Those firms that are most positive about the global situation enjoyed a revenue growth rate of 13.2% and an employment growth rate of 13.9% in 2016. Similarly, businesses that are most positive about the United States economy reported high year-over-year growth rates: 9.5% and 9.4% for revenue and employment respectively.

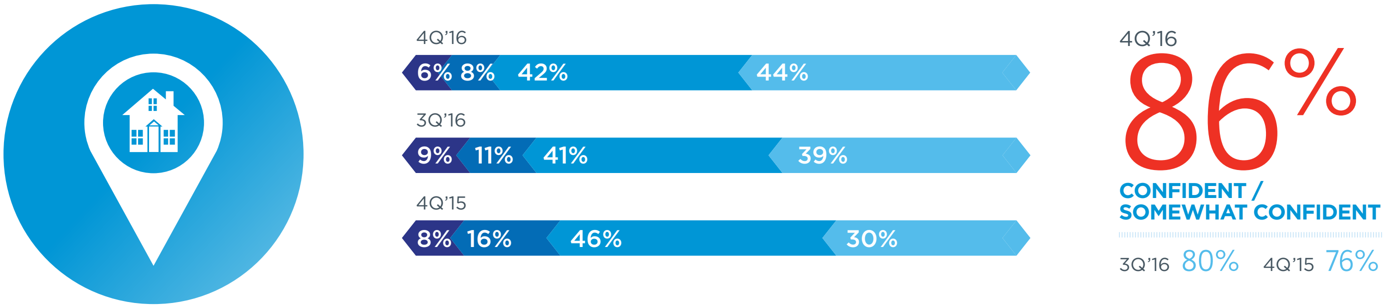
GLOBAL ECONOMY



NATIONAL ECONOMY



LOCAL ECONOMY



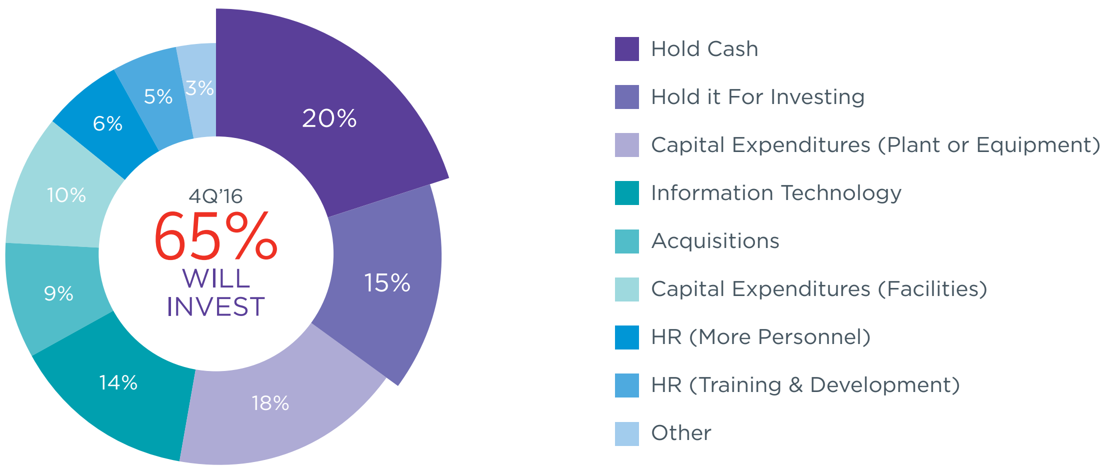
Not confident | Somewhat not confident | Somewhat confident | Confident

CAPITAL INVESTMENT

Investment attitudes remain unchanged

While the majority of middle market businesses say they would an invest extra dollar of revenue, the percentage continues to hover around two-thirds, inching up from 61% at the end of 2015 to 65% for Q4 2016. Just over one-third (35%) of firms continue to say they would hold onto an extra dollar. Among the savers, a little more than half want to build up cash reserves; the remainder say they would save for future financial investments. For the investors, capital expenditures on plant and equipment is the most likely area for spending, with a quarter of companies saying they are highly likely to add a new plant or facility in the next 12 months. Most companies anticipate their capital expenditures to be about the same in 2017 as they were in 2016.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Concerns about talent and the government persist

As middle market companies strive to grow and perform over the next 12 months, core issues, such as maintaining growth and managing capital, remain the greatest challenges. Talent management continues to be an issue, especially retention and recruitment of professional and technical experts, as firms look to overcome skills gaps and compete with each other for the best people. Many firms are considering improving salaries and offering flexible work arrangements to attract talent. Unease over the government's impact on business, especially related to rules and regulations, has been on the rise since the second quarter of 2016, with a quarter of companies saying the government is a concern.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	62%
2. STAFF/EMPLOYEES	45%
3. COSTS	21%
4. GOVERNMENT	16%

EXTERNAL CHALLENGES:

1. BUSINESS	32%
2. GOVERNMENT	27%
3. COMPETITION	16%
4. COSTS	15%
5. ECONOMY	14%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. BUSINESS	39%
2. STAFF/EMPLOYEES	38%
3. COSTS	16%
4. GOVERNMENT	5%

EXTERNAL CHALLENGES:

1. BUSINESS	28%
2. GOVERNMENT	25%
3. COSTS	13%
4. COMPETITION	12%
5. ECONOMY	12%

Perspectives

The Middle Market Indicator has been in existence for five years–a full 20 quarters. The performance U.S. middle market companies posted in the fourth quarter of 2016 is among the highest we have seen during this stretch: Only six times has annualized revenue growth topped this quarter's 6.9% (the average is 6.5%). The increase in employment, 5.4%, is the highest by far (the average is 3.4%). The short-term index–a blend of expectations for business climate, demand, and sales–is at 81, the highest since the first quarter of 2015. The average middle market company expects its profit margins to increase 3.4% next year, the most we have seen in three years. The market seems ebullient.

THE MIDDLE MARKET DRIVES THE U.S. ECONOMY

In every quarter except one (the first quarter of 2012) middle market revenue growth has outpaced that of the S&P 500, often by huge margins (6.9% to 4.4% in this quarter, for example). Revenue for the middle market increased nearly twice as fast as GDP. While one cannot compare those two numbers one-to-one, the proportion is revealing. So, too, are the employment numbers. By our estimation, the middle market produces three out of five net new private-sector jobs. It is often asserted that small business is the engine of job creation in America; the cliché ignores the fact that small companies, with high failure rates, destroy many jobs as well. Five years of MMI data consistently show the middle market producing jobs one-and-a-half or two times faster than either big or small business.

REVENUE GROWTH IS MOSTLY ORGANIC

Expansion is the single largest source of top-line growth in the middle market. Forty-eight percent of middle market companies said they entered new markets in 2016; 63% expect to in 2017. Of course, mid-sized companies have more room to grow than gigantic companies, which almost by definition have few frontiers left; and smaller companies, while they have plenty of running room, have fewer resources to throw into geographic expansion. (Our studies also show that middle market companies could be more aggressive about international expansion than they are.) The number-two source of growth is innovation. Four out of 10 middle market companies introduced a new product or service in 2016; executives say that number will tick up to 42% in 2017.

Acquisitions play a notably smaller role in middle market growth. In 2016 24% of the middle market either made an acquisition or a sale. The number plunges when you remove companies owned by private equity firms, which buy and sell for a living; of non-PE-owned companies, just 17% were involved in a deal in 2016. The year ahead promises much more action: 39% expect to buy or sell. If that materializes, it will be the highest level of M&A activity we have seen in the two years we have been tracking these data.

The preponderance of organic growth in the middle market model may explain its vigorous job creation. While inorganic growth can have many benefits, deals are often done in pursuit of "synergies"–i.e., cost savings–whereas new markets, products, and services usually mean new hiring

MIDDLE MARKET COMPANIES ARE CONSERVATIVELY MANAGED

MMI data, as well as other NCMM studies, depict a sector that on the whole handles money prudently. Only one company in eight says it took on new debt last year, despite historically low interest rates. This quarter, 35% of executives say they would put aside an additional dollar of revenue as savings or for future use rather than put it immediately to work. Over the history of the MMI, we have seen and remarked on the fact that middle market companies are deliberate about hiring–adding workers even in temporary downswings but cautious about hiring early in an upswing. Robust growth and tight-fisted fiscal management are often thought to be at odds with each other. The middle market, which (mostly) does not need to please or appease public shareholders, appears to be able to able to present both a boring balance sheet and an exciting income statement.

TALENT IS THE MIDDLE MARKET'S BIGGEST CONSTRAINT

It stands to reason that the middle market–the most aggressive hirers–would feel a talent pinch more than others. Indeed, middle market companies rank talent management among their top three challenges more often than they do maintaining growth and managing costs combined. Smaller middle market firms are particularly likely to report difficulty recruiting people with the right skills, but talent is a struggle across the board. Nearly four in 10 companies–37%–say lack of talent constrains their ability to grow. Twenty-five percent say that their biggest recruiting challenge is finding salespeople–which by itself would be an impediment to growth.

Now, for the last five years the U.S. has enjoyed steady and moderate growth, low interest rates, cheap energy, negligible inflation, slower increases in healthcare costs, and little cost pressure from materials or wages. It's unlikely that these favorable conditions will entirely persist. If and as they change, the middle market's challenges will change, too. For now, though, the middle market enters the new year–and the MMI its second half-decade–with the highest levels of confidence it has ever shown.

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