

4Q 2012

MIDDLE MARKET INDICATOR



NATIONAL CENTER FOR
THE MIDDLE MARKET

In Collaboration With



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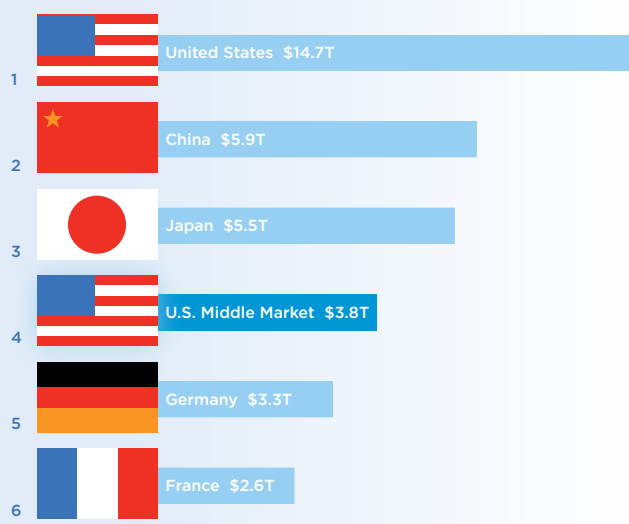
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Middle Market Indicator

from The National Center for the Middle Market

THE MIDDLE MARKET IS THE WORLD'S 4TH LARGEST ECONOMY



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

The Middle Market Indicator (MMI) from The National Center for the Middle Market is a quarterly business performance update and economic outlook survey conducted among 1,000 C-suite executives of companies with annual revenues between \$10MM and \$1B.

There are approximately 197,000 U.S. middle market businesses that represent one-third of private sector GDP, employing approximately 43 million people. These businesses outperformed through the financial crisis (2007–2010 period) by adding 2.2 million jobs across major industry sectors and U.S. geographies, demonstrating their importance to the overall health of the U.S. economy. They are private and public, family owned, and sole proprietorships, geographically diverse, and span almost all industries. The health of these businesses and their respective outlook serve as a solid indicator for the greater U.S. economy as a whole. (See www.middlemarketcenter.org: “Leading from the Middle,” seminal research on the definition, significance, and role of the middle market, Oct. 2011.)

HOW IS THE RESEARCH CONDUCTED?

The MMI surveys 1,000 CEOs, CFOs, and other C-suite executives of America's middle market companies on key indicators of past and future performance in revenues, employment, and allocation of cash. The survey also reports middle market company confidence in the global, U.S., and local economies and identifies key business challenge areas. The survey was designed to accurately reflect the 197,000 U.S. businesses with revenues between \$10MM and \$1B, the upper and lower limits on middle market annual revenue. The quarterly survey is designed and managed by The National Center for the Middle Market.

ABOUT THE NATIONAL CENTER FOR THE MIDDLE MARKET

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

Executive Summary

Middle market companies showed average revenue growth of 7% during the past year, a gain after three quarters of decline. The group also forecasts a gain of 5.2% in revenue in 2013, a strong increase from the previous quarter when respondents anticipated a 3.7% gain over the next 12 months. At that rate, the middle market will pump at least an estimated \$520 billion into the U.S. economy in 2013.

Companies in the middle market added 2.7% to their workforce in the previous 12 months, outpacing the 2.1% expansion for large U.S. firms and the 1.2% growth by small U.S. firms as reported in ADP data.

Overall, three out of five middle market companies surveyed in December said that business performance has improved from last year's fourth quarter. The biggest jump in confidence levels was in the larger segment of the middle market with 12% confident in the global economy compared with just 3% in the previous quarter.

“We are moderately optimistic about the U.S. economy ... it appears we are slowly recovering from the recession.”

— CFO, Pharmaceuticals, \$10 million annual revenues, 40 employees, privately held

Key Findings:



PAST 12-MONTH GROWTH WAS STRONGER THAN INDUSTRY PREDICTIONS:

Middle market companies posted average gross revenue increases of 7% for the past 12 months compared with predictions that companies will see gross revenue grow 5.2% during the next year.

Middle market firms added an estimated 1.17million jobs in 2012 based on a reported growth in employment of 2.7%. They anticipate adding a million more jobs in 2013.

Revenue for the past 12 months improved from third quarter in all industry sectors except for wholesale trade and financial services.



CONFIDENCE IS LOW, BUT IMPROVING:

While confidence remains depressed, the middle market is slowly becoming more optimistic about the global and U.S. economy. Of the firms surveyed, 25% said they were “somewhat confident” in the outlook for the global economy, while 8% are confident. The picture is even better for confidence in the U.S. economy with 36% of respondents “somewhat confident.” Those who are confident in the U.S. prospects rose to 15%, up from 11% in the third quarter.



CAPITAL INVESTMENT IS LIKELY TO PICK UP SLIGHTLY :

Across industries, middle market companies are investing in their businesses instead of hoarding cash, continuing a trend seen in the previous two quarters of 2012. From December’s survey responses, 59% of respondents said they would invest extra money instead of holding it in reserve, up from 56% in the third quarter. Among the largest middle market companies the most commonly cited use of cash was to make acquisitions. But smaller middle market companies said they planned to use the money for technology and capital expenditures.



FIRMS PLAN TO HIRE:

The middle market added 1.17 million net new jobs in 2012. Of those companies surveyed, 42% said their workforce has increased from the same period last year. The average employment growth for middle market companies was 2.7%, compared with 2.1% for large U.S. firms according to ADP numbers.

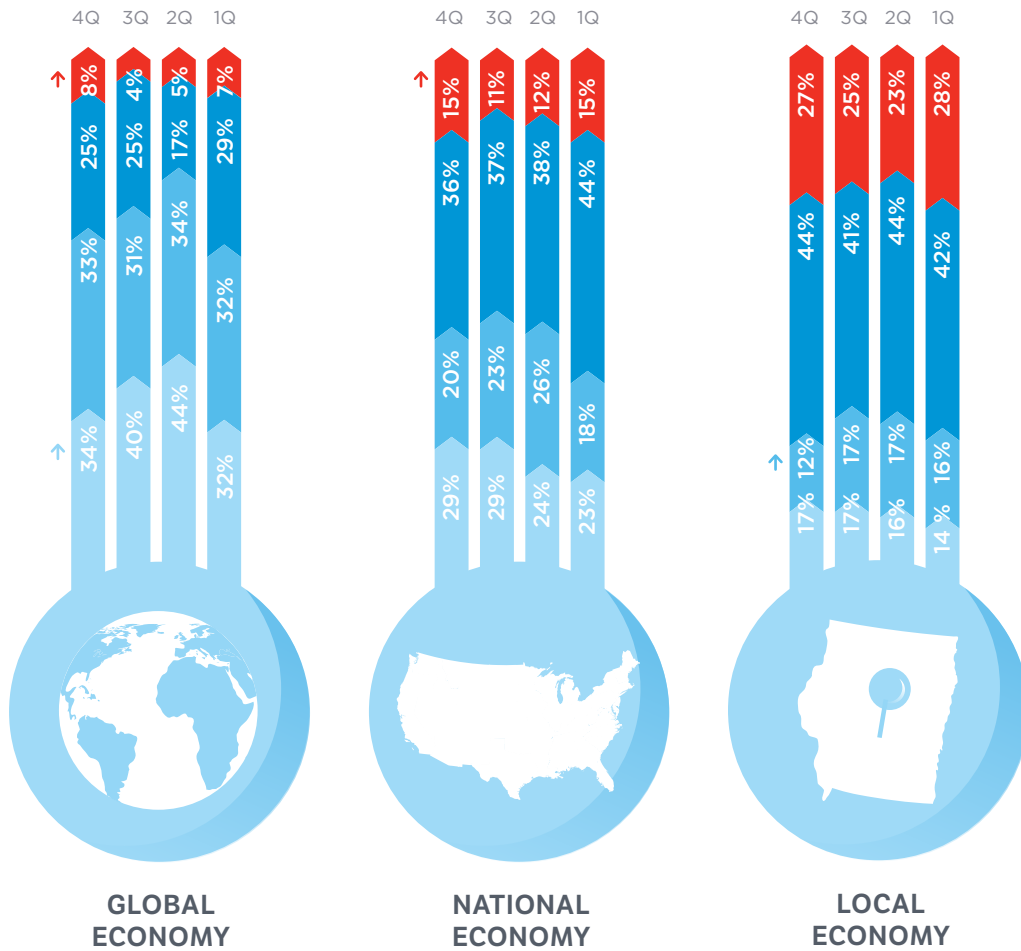


CHALLENGES REMAIN:

Healthcare costs and regulations persist as the biggest challenge to success among all respondents irrespective of their size or sector. Companies also cited uncertainty about government actions and passing on commodities costs, all of which are factors out of their control.

Firms also said they were concerned about their abilities to maintain margins and the rising cost of doing business, making it harder for them to grow revenue. This is unchanged from much of the year’s responses.

Economic Confidence Indicators



Not confident
 Somewhat not confident
 Somewhat confident
 Confident

Growth Indicators

Revenue Growth

MIDDLE MARKET

PAST 12 MO.

4Q **7.0%**

3Q 5.5% 2Q 6.1% 1Q 6.9%

NEXT 12 MO.

4Q **5.2%**

3Q 3.7% 2Q 4.8% 1Q 5.2%

Employment Growth

MIDDLE MARKET

PAST 12 MO.

4Q **2.7%**

3Q 2.2% 2Q 2.0% 1Q 1.5%

NEXT 12 MO.

4Q **2.3%**

3Q 1.3% 2Q 1.8% 1Q N/A

S&P 500

PAST 12 MO.

4Q **2.9%***

3Q 1.6% 2Q 4.8% 1Q 9.4%

NEXT 12 MO.

4Q **3.5%**

3Q 1.5% 2Q 4.0% 1Q 4.7%

S&P 500 (PAST 12 MO.)

LARGE CORP.

4Q **2.1%**

3Q 3.4% 2Q 1.0% 1Q 1.7%

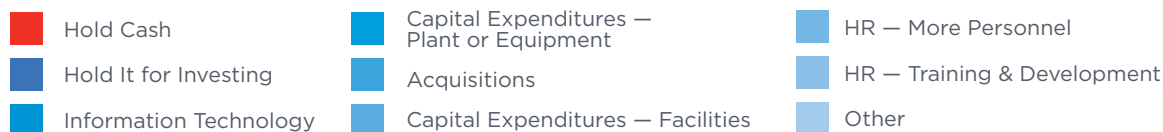
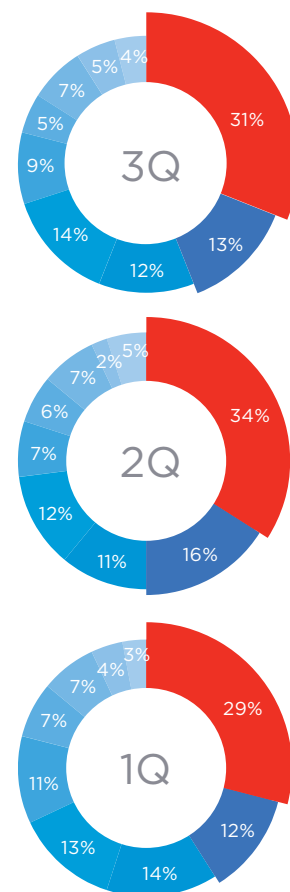
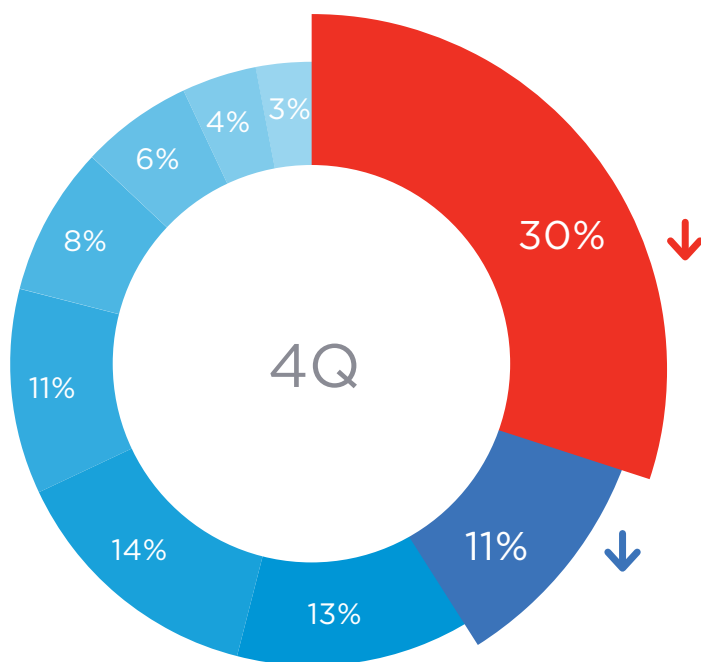
SMALL BUS.

4Q **1.2%**

3Q 1.2% 2Q 1.0% 1Q 1.9%

*Q4 Sales/Share Data not available so estimate was used for calculation.

Incremental Investment Allocation



Recent & Expected Growth

Past 12 Mo. Revenue

BY REVENUE SEGMENT	4Q	3Q	2Q	1Q
10MM-<\$50MM	6.3%↑	5.4%	5.8%	6.0%
\$50MM-<\$100MM	7.4%↑	6.5%	5.3%	6.5%
\$100MM-\$1B	7.9%↑	5.3%	7.0%	8.3%

Next 12 Mo. Revenue

BY REVENUE SEGMENT	4Q	3Q	2Q	1Q
10MM-<\$50MM	5.0%↑	3.8%	4.4%	5.4%
\$50MM-<\$100MM	5.0%↑	3.5%	4.4%	4.8%
\$100MM-\$1B	5.6%↑	3.7%	5.5%	5.0%

The performance of middle market companies clearly is improving compared with a year ago, mirroring signs of growth in the broader economy. All the sectors polled are doing better, although some at a greater rate than others.

Average revenue growth of 7% has picked up from the year's low of 5.5% in the third quarter and surpassed the 6.9% posted in the first quarter.

That means the middle market added an estimated \$650 billion in net revenue to the economy, underscoring that these companies are a significant contributor to GDP.

Southern and western states were the bigger drivers of revenue growth for the middle market in the fourth quarter. In addition, larger middle market companies, those with more than \$100 million in annual revenue, led the increase with an average growth of 7.9%, up from 5.3% in the third quarter but still lagged the first quarter's 8.3% growth rate. Another good sign for the economy is that an increasing number of companies said that revenue grew more than 10%, making bigger gains an important driver for the middle market's overall health.

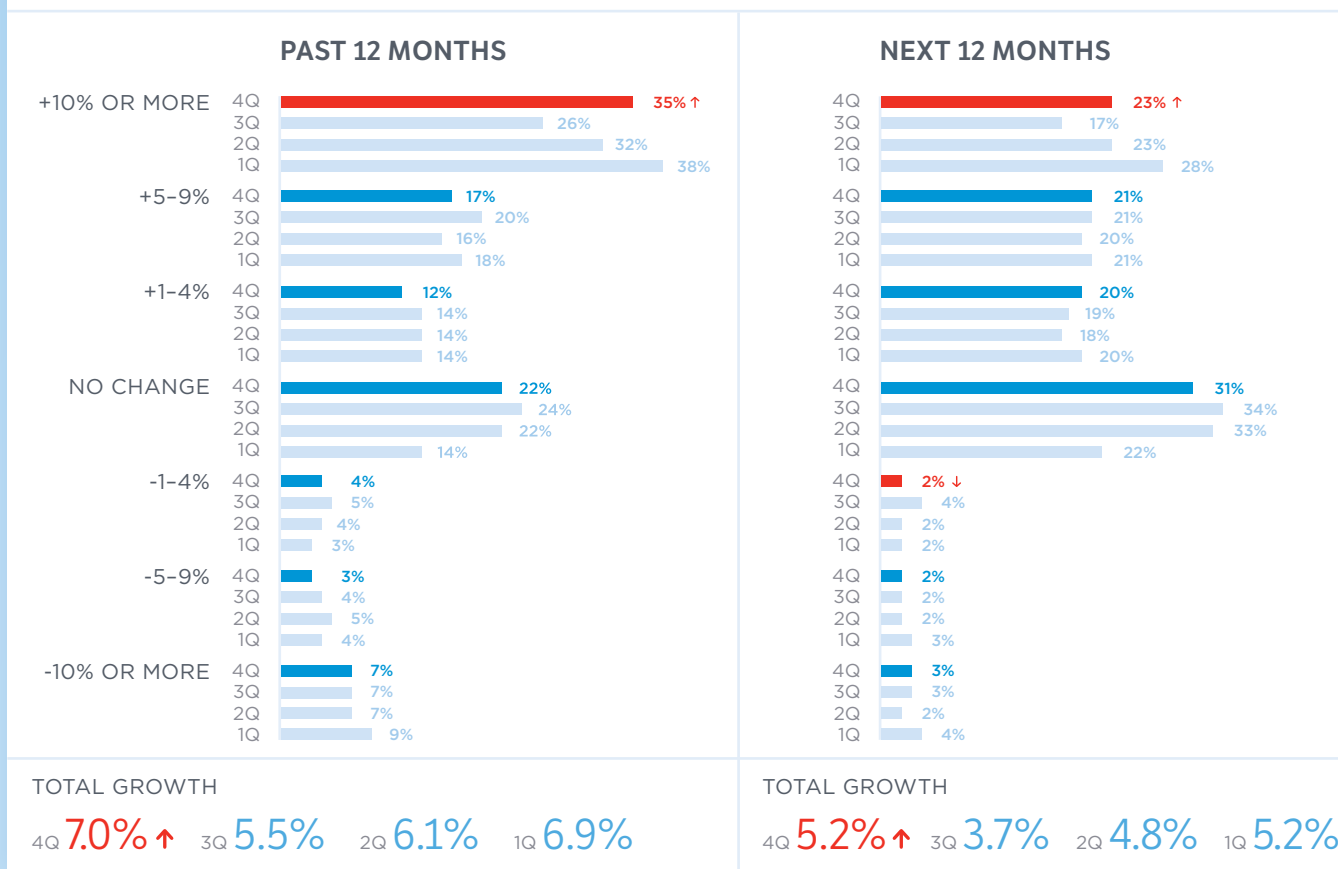
And most of the middle market expects the trend of increasing revenue to continue with an average predicted growth of 5.2% in 2013. That's a significant jump from the third quarter's projection of 3.7% growth and is back to levels expected at the beginning of 2012. At that rate of revenue growth, the middle market will add an estimated \$520 billion in revenue in 2013.

All sectors anticipate gains in the next 12 months, except for manufacturing which is holding steady, with retailers projecting the biggest revenue increase at 5.2% compared with projections of 1.9% in the third quarter. No matter what size the firm, more than half expect growth in 2013.

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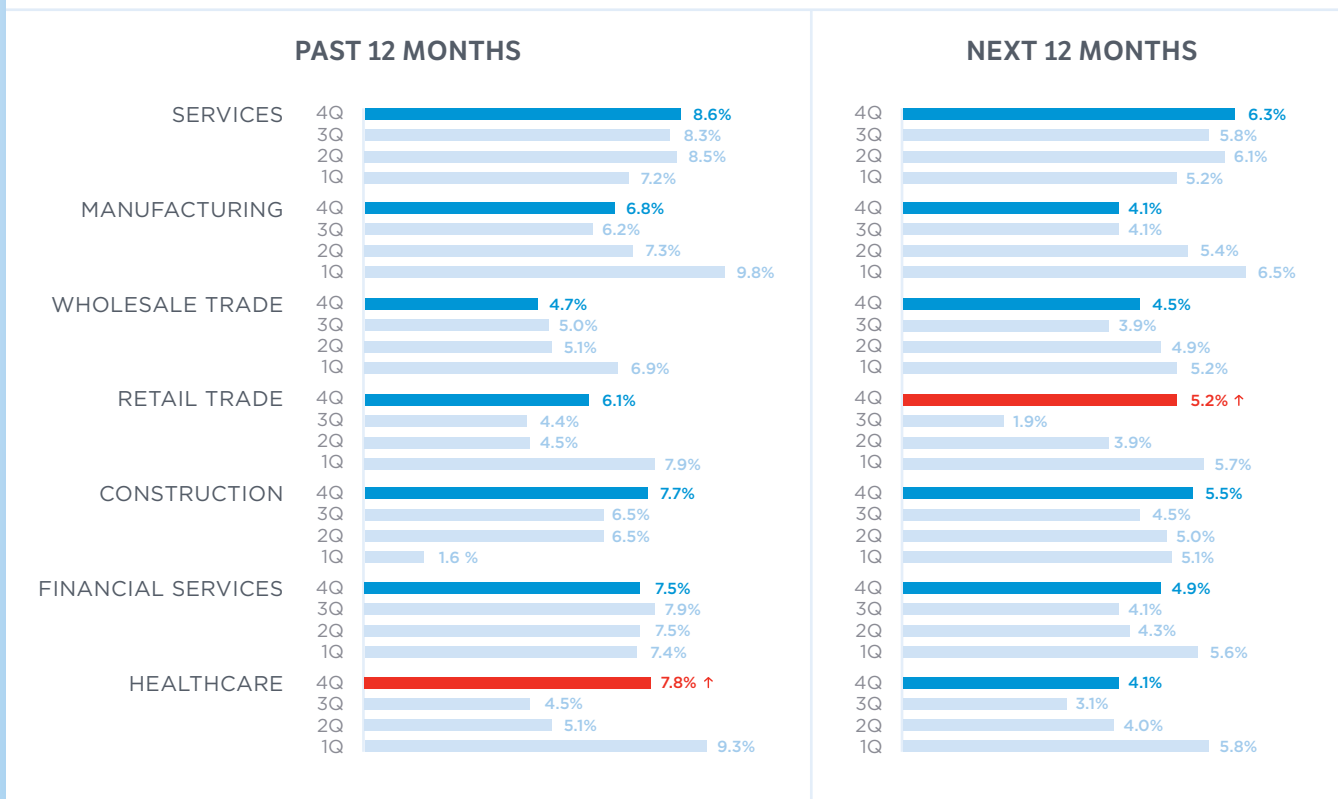
Revenue Performance

Revenue growth continues to slow (vs. the same time period a year ago) and is significantly higher in the 4th Quarter than in the preceding time period.



Revenue Performance by Industry

Overall revenue growth has gained in all industry sectors with the exception of Wholesale and Retail Trade.



Recent & Expected Growth

Past 12 Mo. Employment

BY REVENUE SEGMENT	4Q	3Q	2Q	1Q
10MM-<\$50MM	2.6% =	2.3%	1.7%	1.2%
\$50MM-<\$100MM	2.5% =	2.2%	2.5%	0.7%
\$100MM-\$1B	3.1% ↑	2.0%	2.2%	2.3%

Next 12 Mo. Employment

BY REVENUE SEGMENT	4Q	3Q	2Q	1Q
10MM-<\$50MM	2.5% ↑	1.6%	1.8%	N/A
\$50MM-<\$100MM	1.5% =	1.6%	1.5%	N/A
\$100MM-\$1B	2.4% ↑	0.7%	1.8%	N/A

Continued from previous page...

The middle market also is adding jobs with 42% saying their workforce has increased from the same period last year. The average employment growth for middle market companies was 2.7%, compared with 2.1% for large firms according to ADP numbers. An estimated 1.17 million jobs were added by the middle market in 2012.

Companies of all sizes and across industry sectors are adding jobs. Retail trade added the most workers in the fourth quarter compared with the third, much of which likely is seasonal workers. While these additions are positive, they are modest in terms of overall numbers and middle market companies remain cautious about the outlook for their businesses.

Still, many middle market companies didn't add jobs during 2012 as they waited to see how much if any the overall economy will improve. Some may have increased overtime as opposed to hiring additional workers. This can be expensive and eventually many will have to evaluate their staffing levels.

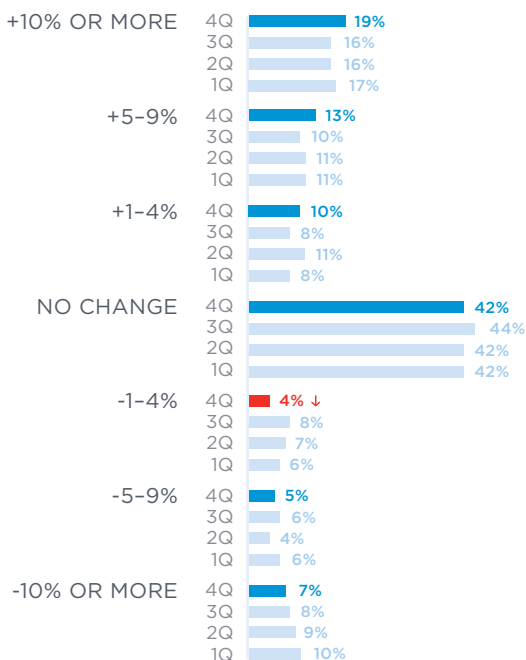
Much of the gains in employment are likely to continue with 42% of middle market companies saying they plan to add workers in the coming year. The overall average expected increase in employment is 2.3%, or about one million additional jobs in 2013. These additions are expected across sectors and in firms of all sizes.

With nearly a third of the private sector GDP and employment in the U.S. coming from the middle market, such an outlook augurs well for the national economy.

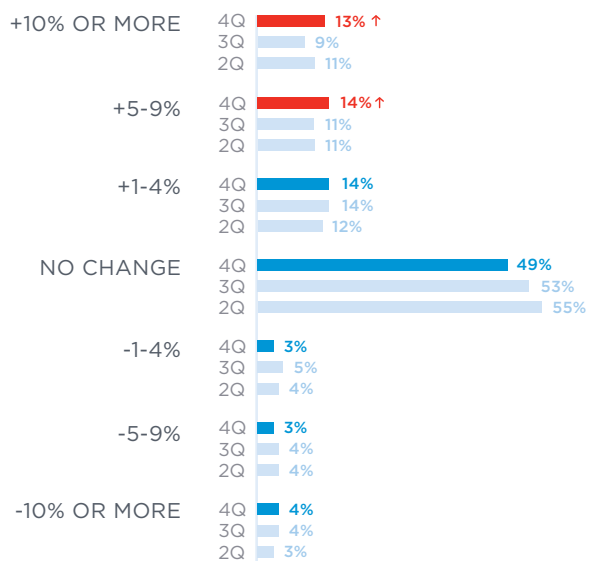
Employment Performance

Employment growth relative to the 3rd Quarter is up. 42% say their workforce has increased since the same time period one year ago.

PAST 12 MONTHS



NEXT 12 MONTHS



TOTAL GROWTH

4Q **2.7% ↑** 3Q **2.2%** 2Q **2.0%** 1Q **1.5%**

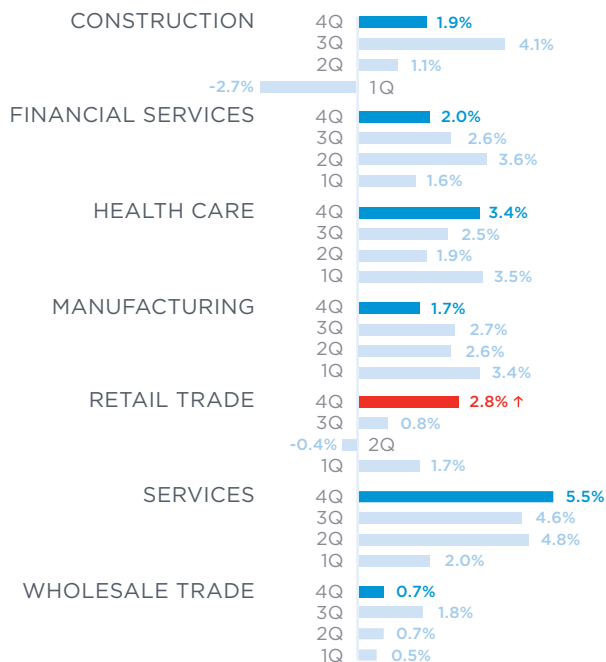
TOTAL GROWTH

4Q **2.3% ↑** 3Q **1.3%** 2Q **1.8%** 1Q **N/A**

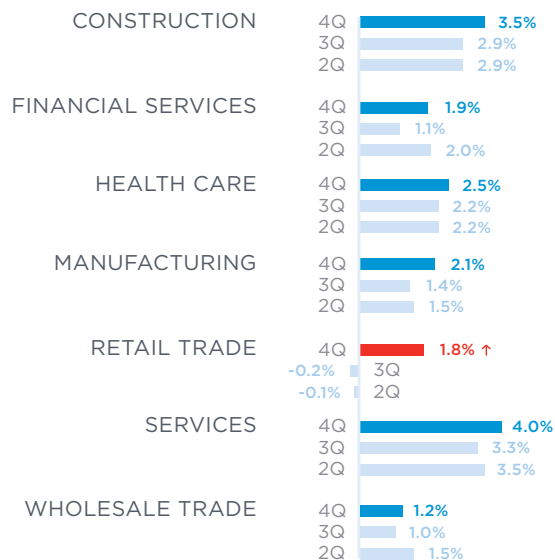
Employment Performance by Industry

Relative to the 3rd Quarter, Employment growth is significantly higher for retail trade and stable in other industry sectors.

PAST 12 MONTHS



NEXT 12 MONTHS



Confidence & Future Outlook

Confidence in the economy and business improved in the fourth quarter from the middle of the year, but not dramatically. Roughly half of middle market companies are at least “somewhat confident” in the U.S. economy with larger organizations showing the biggest increase.

Confidence in the local economy remains higher than sentiment about the U.S. with 27% of firms confident about their local areas compared with 15% confident about the U.S. That drops to 8% when talking about the global economy. While these numbers are low, they are better than the third quarter and similar to first quarter levels.

Responses regarding investment decisions, which indicate how companies feel about the future, somewhat align with the improved outlook on revenues and employment among middle market firms. If given an additional dollar, 59% of middle market executives in the fourth quarter survey would choose to invest it, which is more than the 56% in the third quarter.

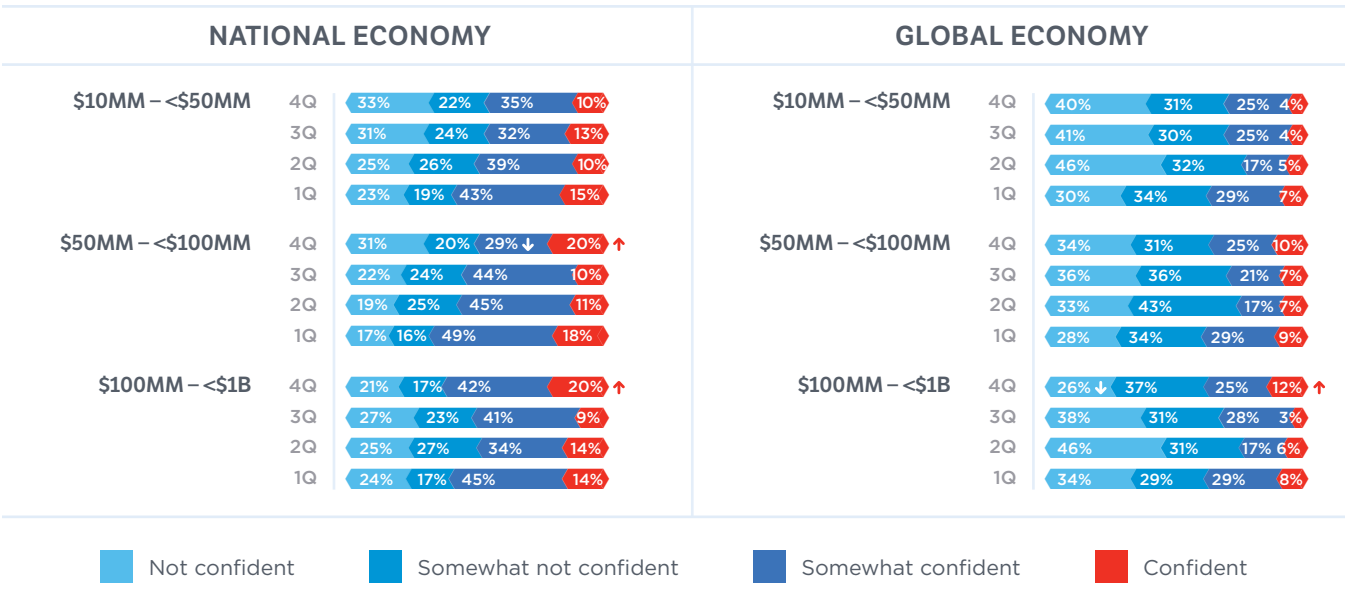
While an improvement, a high proportion, 41%, of the executives continue to choose to hold the extra dollar as cash or as marketable securities. Of those who plan to invest their capital, most intend to use it for growth, expansion or acquisitions. Companies also are looking at using cash for technology or capital expenditures.

“We are trying to invest in advanced equipment to increase our capacity and reduce our manual workforce to help offset the increasing costs of health care and pensions.”

— CFO, Wholesale & Distribution, Manufacturing, \$100 million annual revenues, 625 employees, privately held

Confidence by Revenue Segment

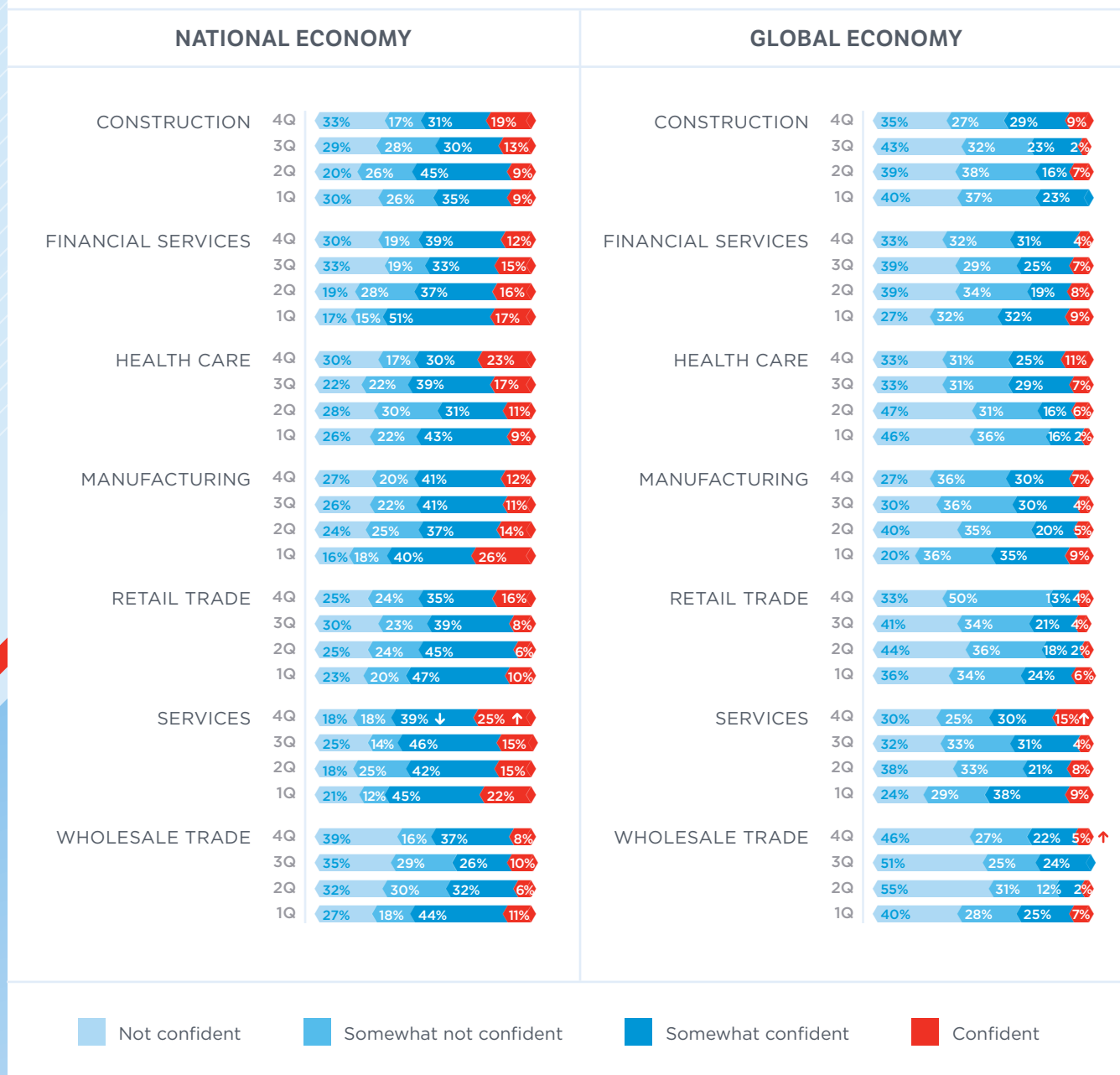
Confidence in the US among middle and large size firms is increasing.



Base: Total Respondents: 4Q=1000; 3Q=1000; 2Q=1000; 1Q=1002.
Note: Arrows indicate significant difference compared to immediate previous time period.
Q7. How confident are you in each of the following?

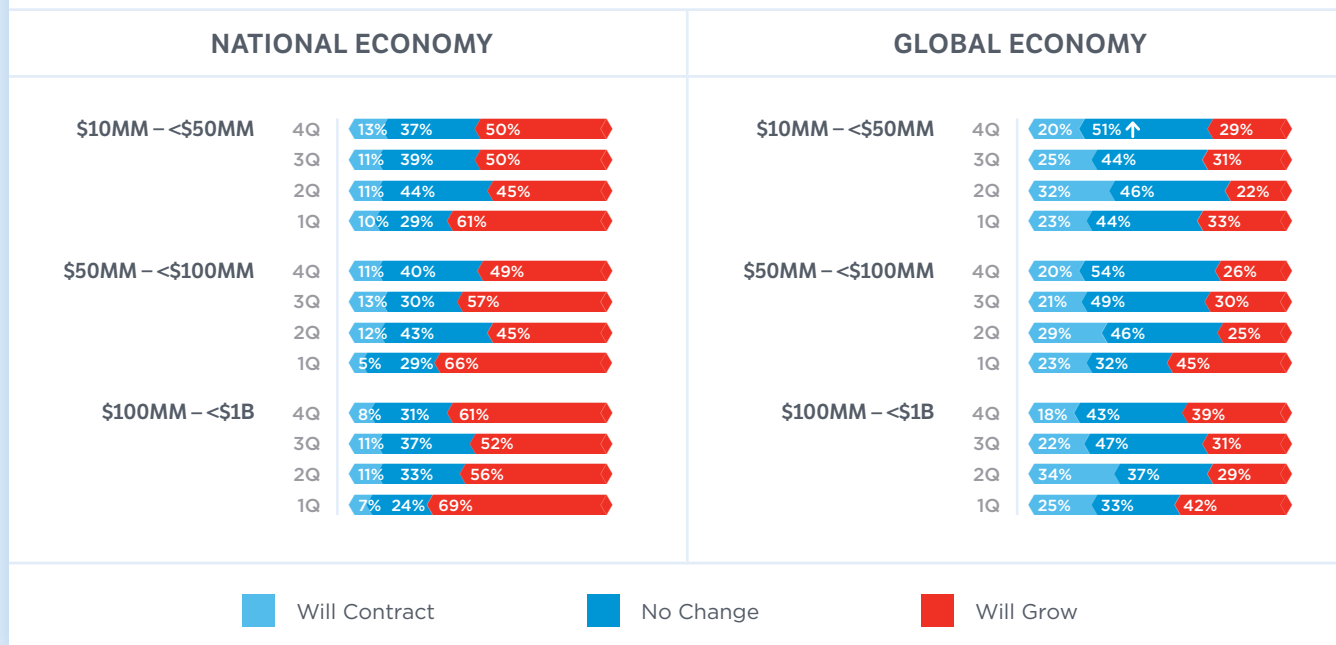
Confidence by Industry

With the exception of services, no one sector displays an overwhelming confidence in either the Global or US economies.



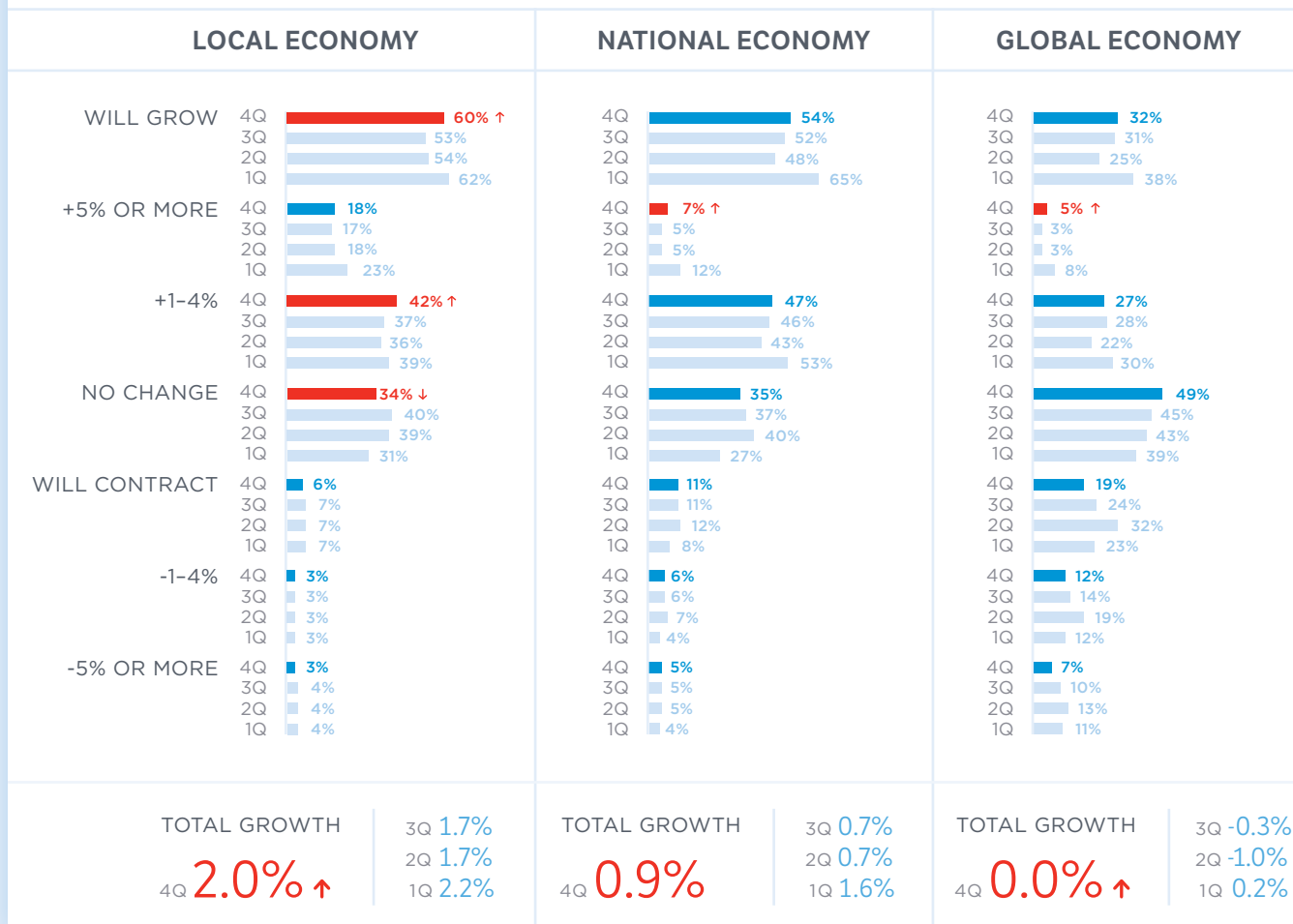
Economic Growth Outlook by Revenue Segment

Across the revenue segments, the future economic outlook for the Global and US Economy is unchanged since the prior period.



Economic Growth Outlook

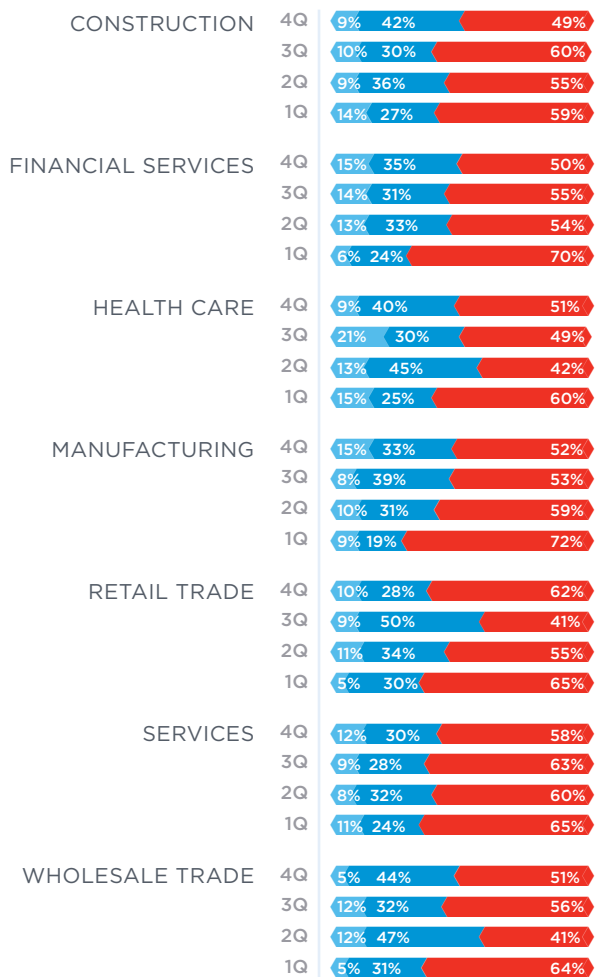
Assessments for positive growth are evident in the local economy and on the firm level.



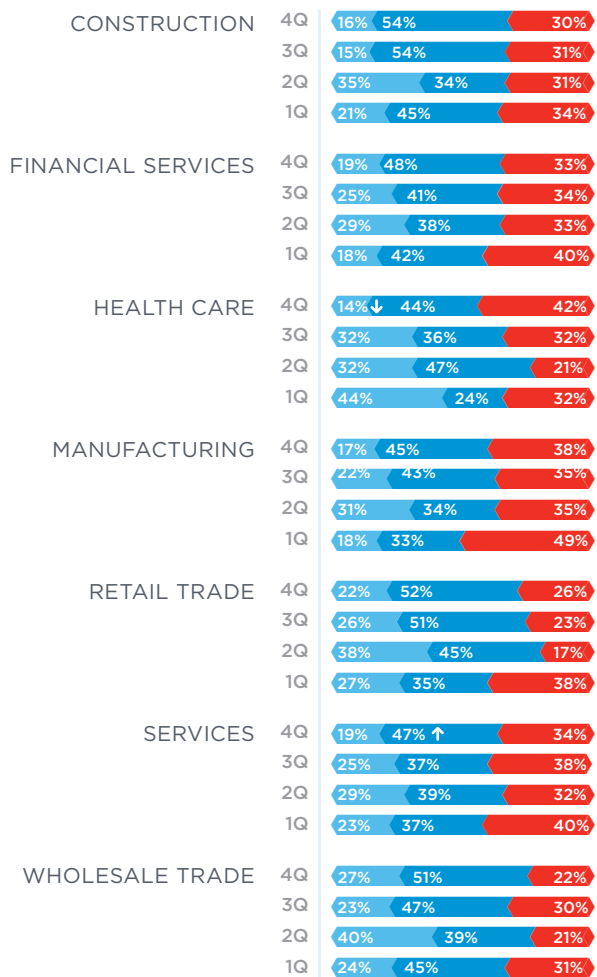
Economic Growth Outlook by Industry

The outlook is stable for most sectors of the middle market.

NATIONAL ECONOMY



GLOBAL ECONOMY



Will Contract

No Change

Will Grow

“Health care cost is a critical unknown factor going forward.”

— CEO, Manufacturing, \$20 million annual revenues, 75 employees, privately held

“Depending on how Washington handles the so-called ‘debt ceiling,’ it might be a minor plus or minor negative year — perhaps a continual state of ‘wait and see.’”

— Chairman, Media & Entertainment, \$100-\$250 million annual revenues, 625 employees, privately held

Challenges

Despite events in the fourth quarter, such as the outcome of the U.S. presidential election, middle market executives say they are facing most of the same challenges as earlier this year. This means that the majority of respondents still feel their businesses are affected by factors largely out of their control.

Not surprising, the cost of healthcare remains the biggest challenge for middle market firms with 90% of respondents calling it somewhat or highly challenging. This is unchanged from most of the year and remains a constant across size, industry and confidence level. This is likely to weigh heavily on staffing and other employee-related decisions in 2013, with 47% of respondents indicating that would be the case.

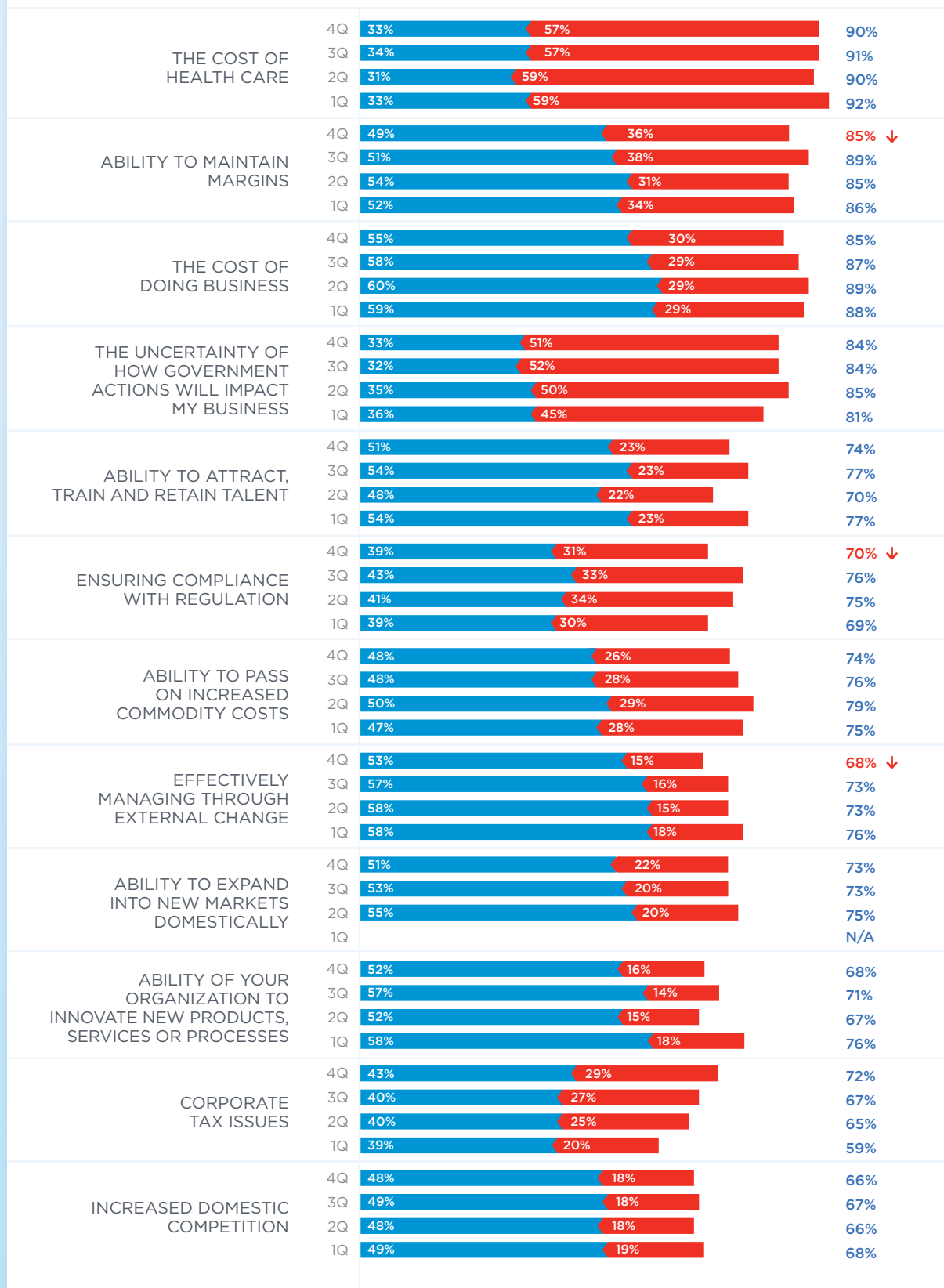
Healthcare costs are causing managers to weigh their options and to reconsider what types of investments they’ll make going forward. Only 35% of respondents said it would have no impact on how they do business. Besides freezing hiring, managers are considering putting less money into technology and operations.

Besides healthcare, executives are concerned about the ability to continue to grow revenue and the cost of doing business with 86% and 85% respectively calling it highly or somewhat challenging. Margins are also coming under pressure as 85% of managers citing it an area to watch.

There were a couple of areas that managers felt less pressure from in the fourth quarter. The number of executives saying that complying with new regulations was challenging fell to 70% in the fourth quarter from 76% in the third quarter. Those who found managing through external change a problem fell to 67% from 73% in the previous period.

Key Challenges

Healthcare costs and other margin pressures are most challenging to Middle Market Leaders. Regulation and uncertainty of government actions are also key issues.



Somewhat Challenging



Highly Challenging

Perspectives

The middle market continues to be an important component of the economy, driving growth in the U.S. and locally. Since actual and predicted revenues have been better than gains in the S&P 500, these companies also are critical to the economic recovery. Despite challenges such as the cost of healthcare and maintaining margins, most companies plan to hire more workers with the potential to add one million jobs in 2013. Another positive sign is that companies aren't hoarding as much cash and making plans to put it to work and invest in their businesses. Revenue grew at about 7% for the past 12 months and is expected to remain strong in 2013. Most executives tend to underestimate their projected revenue, meaning that the 5.2% prediction likely will be surpassed.

MIDDLE MARKET INDICATES STRONGER GROWTH FOR THE U.S. ECONOMY

The fourth quarter results for the middle market suggest a notable change in trends that point to increasing expansion in the broader economy after a year of mostly tepid GDP growth. Talk and fears of a double-dip recession are quietly receding.

The resolution of the U.S. presidential election and the fiscal cliff debate and increased confidence in the global economy are all likely factors contributing to higher growth levels and predictions for 2013. Middle market companies reacted favorably to the clarity provided by the elections and the resolution of the fiscal cliff, and positive news coming from global economies.

Global economies have been growing strong, suggesting positive growth for Middle Market company exports. The World Bank recently increased its estimate for China's GDP growth to 8.4% for 2013, citing fiscal stimulus and faster approval of large investments (East Asia and Pacific Economic Update, December 19, 2012). India also cleared contentious reform that opened a vast market in retail to FDI, leading Goldman Sachs to increase India's GDP growth estimate. While the short-term expectations for Europe remain bleak, in its November European Economic Forecast, the European Commission now predicts a gradual recovery through 2013 and GDP growth of about 1.5% in 2014 (Autumn 2012 report).

BUT UNCERTAINTIES AND CHALLENGES PERSIST

The uncertainty of future government actions, healthcare costs, ability to grow revenue, the cost of doing business, and ability to maintain margins are all top challenges for middle market firms. In various ways, these challenges are tied to uncertainties in the environment. It remains to be seen how healthcare regulations will be applied and costs levied, and what options middle market companies can effectively use in response.

Commodity prices rose significantly last year, and they might impact the cost of doing business and the ability of middle market companies to maintain margins. Unlike large firms, middle market firms largely don't have the leverage to control price swings.

One way to grow revenues is to go abroad, which many middle market companies consider quite risky (see NCMM sponsored research, "U.S. middle market firms and the global marketplace: Should I stay or should I go?"). Finally, it is notable that access and affordability of capital are not reported among the top challenges. This is understandable in light of many continuing to hoard cash.

IMPROVED INVESTMENT PLANS REMAIN DAMPENED BY UNCERTAINTIES

While the number of respondents planning to invest extra cash rose, a large number continue to hold onto their money. From just the uncertainties attached to the fiscal cliff, executives have reported a mean drop of nearly 5% in investment (survey question: "How much have you reduced your investment spending because of uncertainties for your industry due to the fiscal cliff?"). Clarity from the elections notwithstanding, many uncertainties persist, which is depressing investment.

Overall, in the fourth quarter survey we see positive changes in the middle market that can be the basis of cautious optimism for the U.S. economy in 2013.



**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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