

2Q 2013

MIDDLE MARKET INDICATOR



NATIONAL CENTER FOR
THE MIDDLE MARKET

In Collaboration With



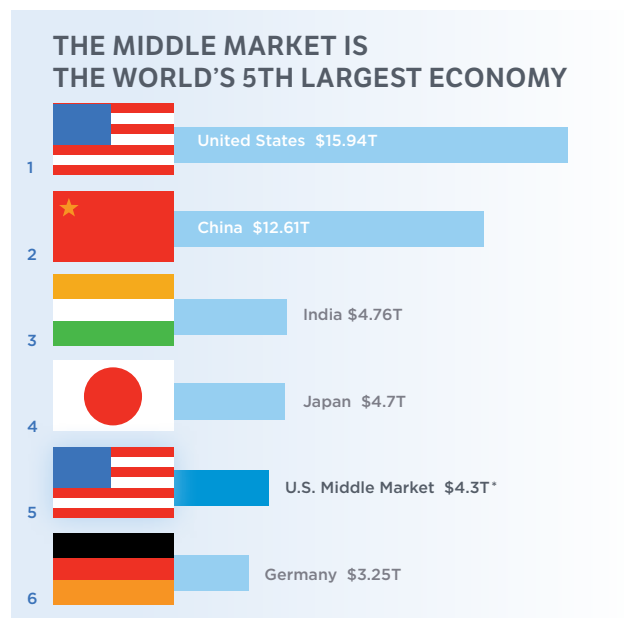
GE Capital

Table of Contents

Executive Summary	4
Key Findings	5
Recent and Expected Growth	8
Confidence and Future Outlook	16
Challenges	20
Perspective	22

Middle Market Indicator

from The National Center for the Middle Market



Source: CIA World Fact Book, *National Center for the Middle Market (estimate)

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

U.S. middle market companies posted solid revenue gains and added workers in the second quarter of 2013 – trends expected to continue in the next 12 months – sending a clear signal that business conditions for the segment have stabilized and serving as an indicator that the overall economy continues to improve.

Middle market companies, defined as those with annual revenues of \$10 million to \$1 billion, reported sustained increases in revenue and employment during the period, reversing declines seen earlier in the year. Stabilizing top-line growth and increased employment are fortifying optimism. Middle market executives increasingly feel confident about prospects for global, national and local economic activity. As a result they expect revenue growth to continue and they expect to add jobs in the next twelve months at a more rapid pace.

The gains in revenue, employment and confidence among this group could prove to be a harbinger for a broader economic rebound. The middle market serves as a critical engine for the U.S. economy, accounting for approximately one-third of non-government GDP and more than one-of-three domestic jobs. Middle market revenue increases of 5.8% for the first half of 2013, and expectations for greater than 5% increases for the next 12 months, far outpace analysts' 1.2% revenue growth estimate for the S&P 500 Stock Index, underscoring the importance of these businesses.

Despite strong performance and forecasts, challenges remain. Healthcare policies mandated by new legislation are chief among the concerns of middle market managers. The group also cites concerns about other government regulations and finding the right workers, a gap in skills that is preventing them from adding even more jobs. There has been little improvement in the severity of these concerns in recent quarters.

There is little middle market companies can do to solve these lingering issues – but if they are resolved, growth can accelerate at a more significant pace. In part, that's because middle market companies now report a 2-1 margin in their willingness to invest cash, an increase from a year ago.

“We’ve been able to grow the top line as our customer base continues to make more investments in products like ours. In turn, we’ve been able to invest several million dollars in new products over the past 18 months and develop solutions that perform more efficiently.”

— CEO, Technology Services, \$55MM annual revenues, 270 employees

Key Findings:



COMPANY PERFORMANCE CONTINUES POSITIVE MOMENTUM

Revenue growth continues as 65% of middle market companies reported positive gross revenue performance during the past 12 months. That's up marginally from 63% in the first quarter of 2013 and 62% in the second quarter of 2012. The mean revenue growth remained static at 5.8%, with the core of the middle market – those businesses with between \$50 million and \$100 million fueling much of the gains. Manufacturers reported strong growth, offsetting sluggish results in the retail sector.

Companies also expect performance in the coming year to improve with 65% projecting revenue to grow, up from 64% in the previous quarter. Further, these companies expect increases to be bigger – a 5.1% growth rate, up from expectations of 4.9% growth in the first period of 2013.



EMPLOYMENT GROWTH EXPECTED TO CONTINUE

In the second quarter, there was a significant rise in the percentage of middle market companies reporting an expectation to add jobs in the next 12 months, with 43% of companies anticipating adding workers in the year ahead, up from 38% in the first quarter. That marks a 13% gain in the number of companies looking to expand.

In addition, these companies plan on ramping up their hiring to a 2.5% clip, almost one-fifth ahead of the 2.1% gain they had forecast in the first quarter of the year.

Employment growth expectations are dispersed across the middle market with all industry sectors anticipating adding workers during the year. Larger middle market companies forecast that they will add the most workers – those companies that have at least \$100 million in revenue projecting mean growth increases of 3.3%, up from 2.2% in the year earlier period.



CONFIDENCE IS RISING STEADILY

Companies are becoming more confident in the global, U.S. and local economies. Almost half of surveyed companies say they are at least somewhat confident in the global economy, more than double the 22% that reported similar sentiments a year ago. Almost two-thirds of respondents said they are at least partly confident in prospects for the U.S. economy, up from 50% a year earlier. And a resounding 78% of companies are confident or somewhat confident of their local economies, up from 67% a year earlier.

Confidence is growing across middle market companies of all sizes. Executives in services, manufacturing, wholesale trade and construction businesses were especially optimistic about global prospects, while service industry executives fueled confidence gains in the U.S. economy.



CAPITAL INVESTMENT POISED TO SURGE

Middle market companies are sending a strong message that they are poised to invest capital to add jobs, equipment, make acquisitions or train employees – signaling continued growth.

The percentage of company executives who say they will invest rather than hold extra cash on hand increased from 49% a year ago to 64% in the second quarter of 2013. This trend correlates with increasing confidence and stems from the stability of their revenue and employment base.

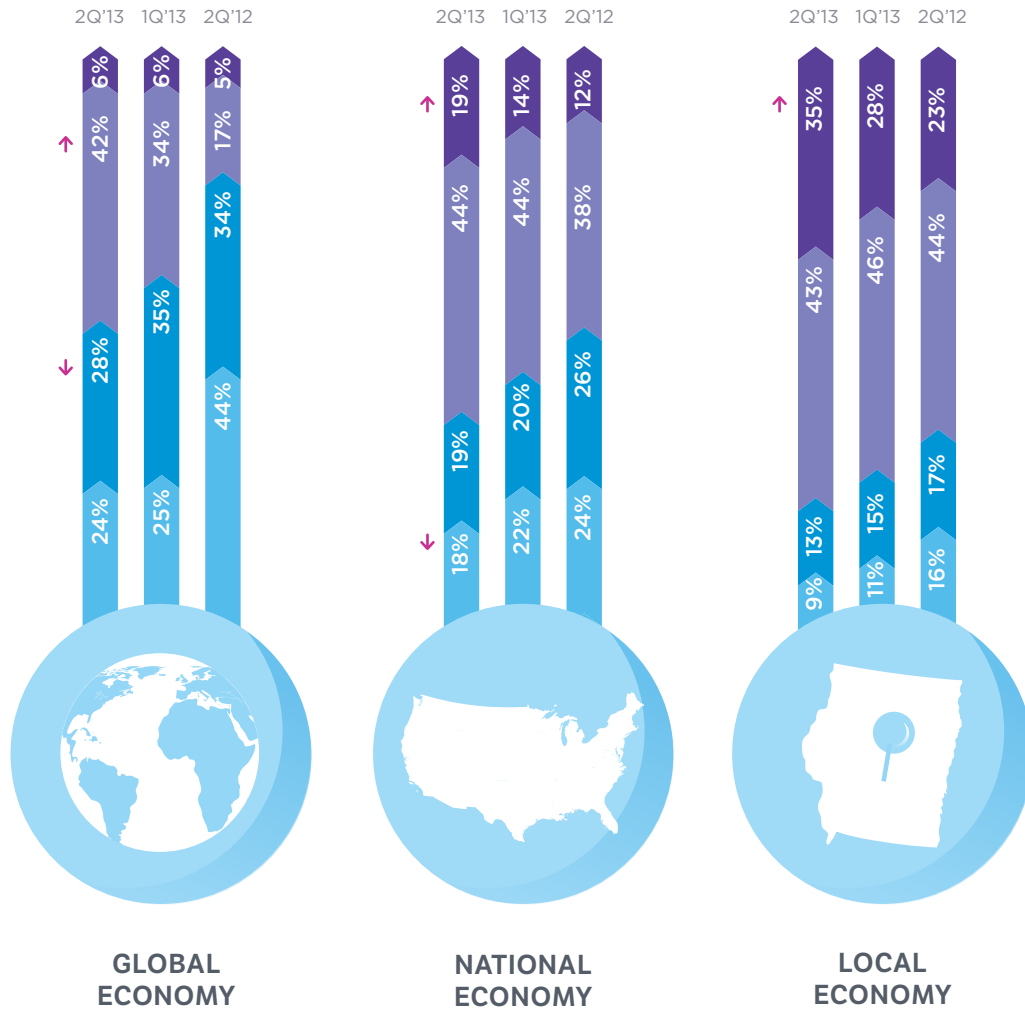


CHALLENGES PERSIST

The impact of healthcare legislation continues to be the main concern among middle market executives of companies of all sizes. Despite a delay in the implementation deadline as the new legislation approaches, companies remain unclear as to its impact.

Uncertainty over other government actions and the ongoing ability to grow revenue and maintain margins also continue to rank among the leading concerns of middle market executives.

Economic Confidence Indicators



Not confident
 Somewhat not confident
 Somewhat confident
 Confident

Growth Indicators

Revenue Growth

MIDDLE MARKET

PAST 12 MO.

2Q'13 **5.8%**

1Q'13 5.8% 2Q'12 6.1%

NEXT 12 MO.

2Q'13 **5.1%**

1Q'13 4.9% 2Q'12 4.8%

Employment Growth

MIDDLE MARKET

PAST 12 MO.

2Q'13 **2.6%**

1Q'13 2.2% 2Q'12 2.0%

NEXT 12 MO.

2Q'13 **2.5%**

1Q'13 2.1% 2Q'12 1.8%

S&P 500

PAST 12 MO.

2Q'13 **3.1%***

1Q'13 5.6% 2Q'12 4.8%

NEXT 12 MO.

2Q'13 **1.2%**

1Q'13 2.8% 2Q'12 4.0%

ADP (PAST 12 MO.)

LARGE CORP.

2Q'13 **2.2%**

1Q'13 2.3% 2Q'12 2.4%

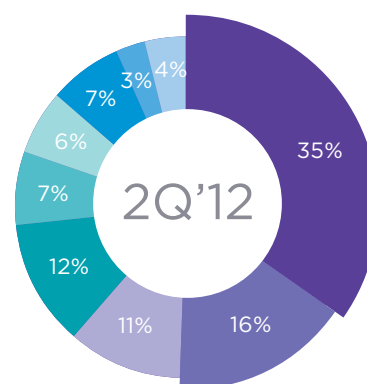
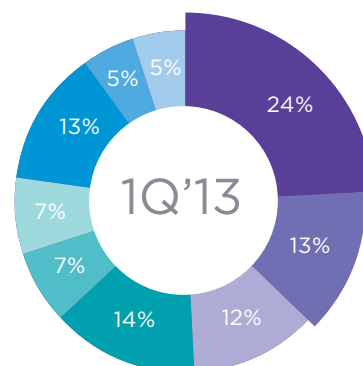
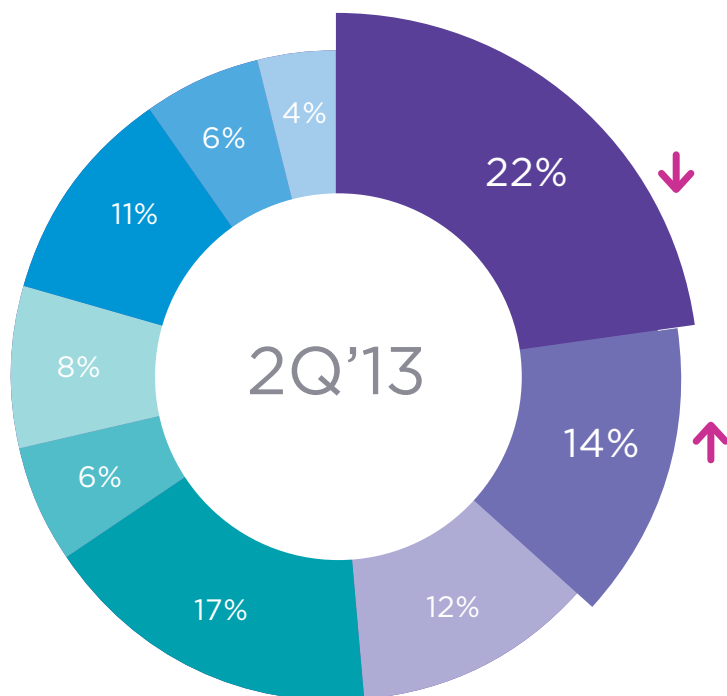
SMALL BUS.

2Q'13 **1.6%**

1Q'13 1.5% 2Q'12 2.3%

*2Q Sales/Share Data not available. Figure based on estimate.

Incremental Investment Allocation



Recent & Expected Growth

Revenue

The performance of middle market companies and revenue growth improved in the second quarter of 2013. Of the companies surveyed, 60% said business in the period improved compared with the first quarter of 2012.

That reverses the decline in the first quarter, when 58% reported improved company performance (down from 62% in the fourth quarter of 2012). Only 8 % of those surveyed said that business deteriorated compared with 10% in the first quarter.

Average revenue growth remained steady at 5.8% for the first two quarters of 2013. That is down from the 7% rise in the fourth quarter of 2012 and marginally below the 6.1% revenue growth in the second quarter of 2012. The results, while below highs hit last year, indicate a foundation of sustainable annual revenue growth in excess of 5%.

It was the larger middle market companies – those with more than \$100 million in revenue – that powered the top-line gains in the period. Revenue growth among those companies rose to 6.9%, up from 5.8% in the previous quarter.

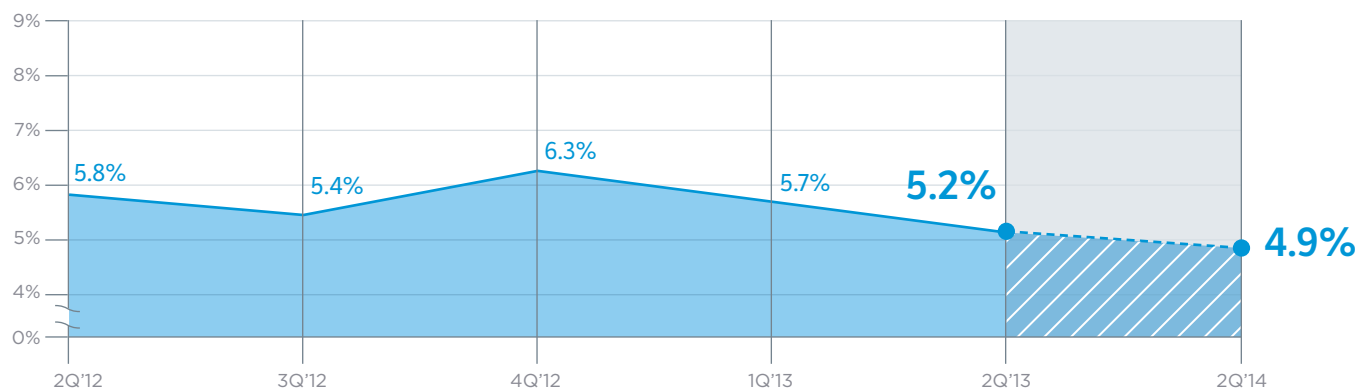
Moving forward, the core of the middle market – the companies with annual sales between \$50 million and \$100 million – anticipates contributing heavily to growth. Seven out of 10 of these respondents said they expect revenue gains in the next 12 months, and only 4% expect declines (down from 8% in the previous quarter).

Overall, the middle market expects revenue growth to taper off a bit, but remain above 5% (5.1% according to the survey). That's an uptick from the 4.9% anticipated revenue growth estimate in the first quarter, and an increase from the 4.8% estimate issued a year earlier.

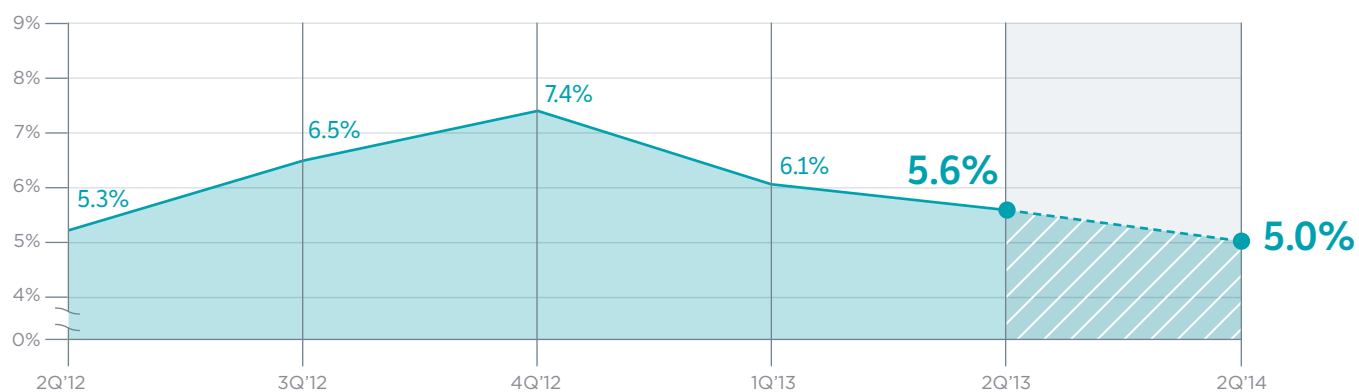
Service and financial firms project the highest revenue gains, with forecasts of 6% and 6.2%, respectively. Conversely, retail trade and healthcare companies anticipate revenue gains of 4.2% and 4.8%, respectively.

Revenue Growth By Segment

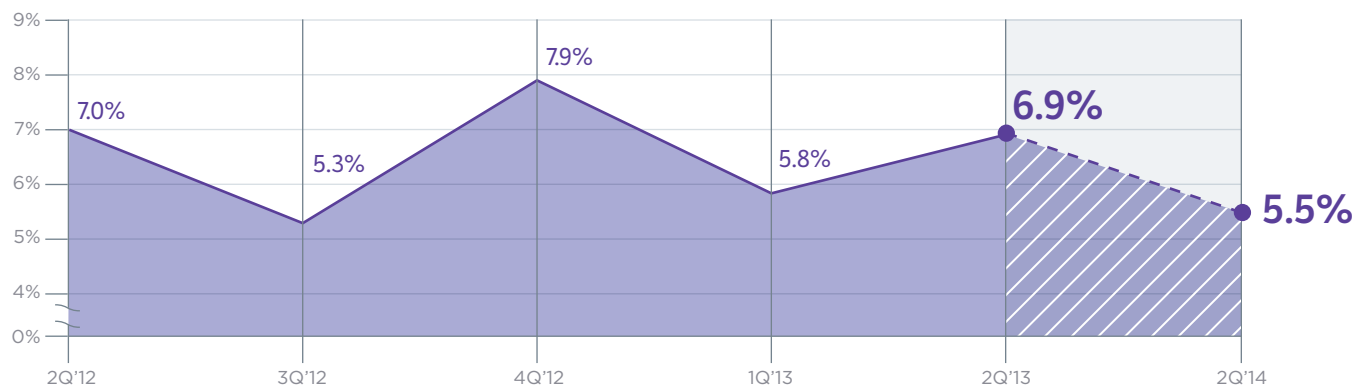
\$10MM—<\$50MM



\$50MM—<\$100MM



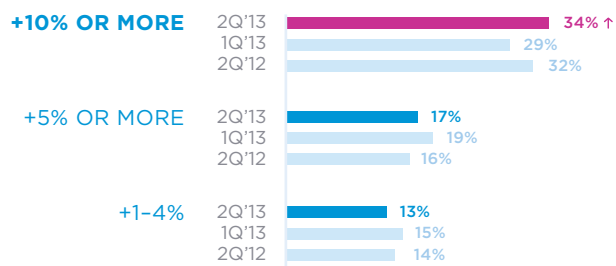
\$100MM—\$1B



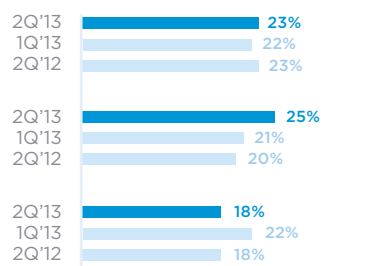
Revenue Performance

The positive growth seen last quarter has continued into the second quarter of 2013.

PAST 12 MONTHS



NEXT 12 MONTHS



TOTAL GROWTH

2Q'13 **5.8%**
1Q'13 5.8% 2Q'12 6.1%

2Q'13 **5.1%**
1Q'13 4.9% 2Q'12 4.8%

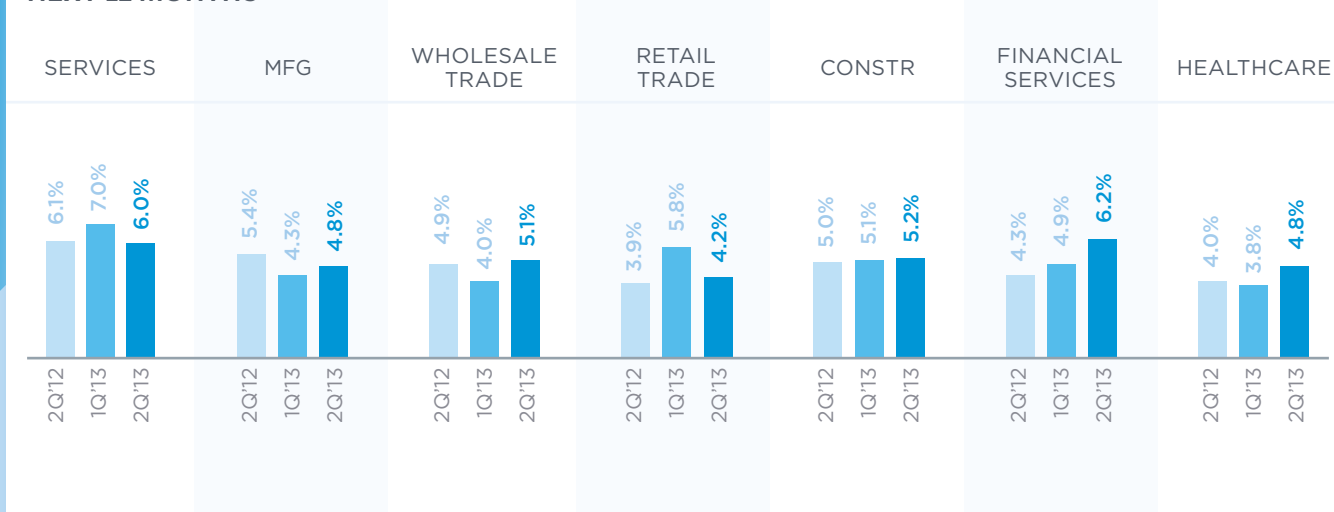
Revenue Performance by Industry

Middle market manufacturers have partially recovered from the drop in revenue seen in the first quarter of 2013.

PAST 12 MONTHS



NEXT 12 MONTHS



Recent & Expected Growth

Employment

Keeping in line with forecasts for sustained revenue growth, middle companies expect to pick up their pace of adding workers. Of the survey respondents, 43% said they will hire workers, a 13% increase from the 38% that said they would add jobs in the previous quarter. The mean total employment growth forecast surged from 2.1% to 2.5%, up 20% from the first quarter.

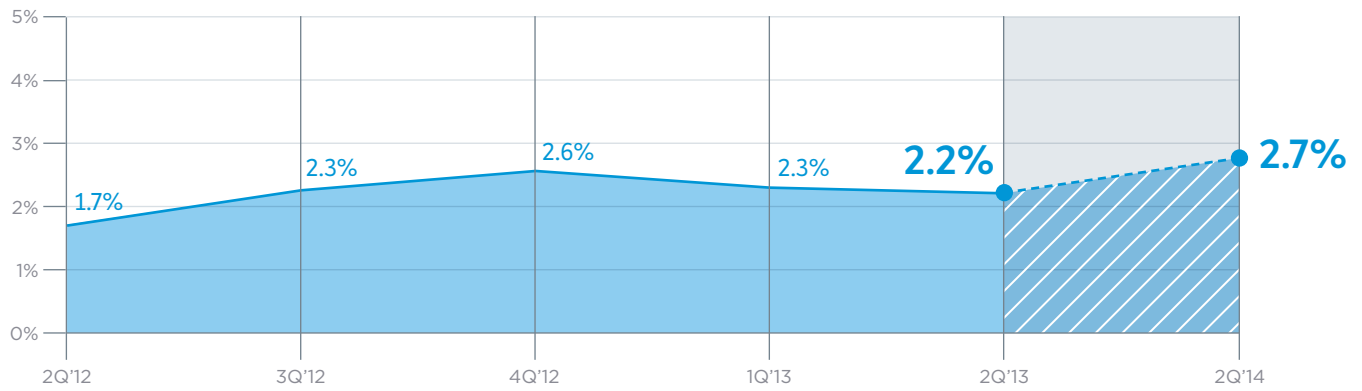
Expectation for job growth among the core middle market firms rose to 39% from 32% in the quarter and they expect to add jobs at a 2.6% clip, more than double the 1.1% rate in the first quarter and well above the 1.5-1.6% range forecasted last year.

After a dip in the first quarter, the hiring expectations of respondents in the manufacturing sector rebounded. In the second quarter this group said they expect mean total employment growth to be 2.2%, up from 1.2% in the first quarter. The services sector continues to have the strongest expectation for adding jobs, forecasting a 4.1% gain in employment, the third consecutive quarter of at least 4% job growth expectations.

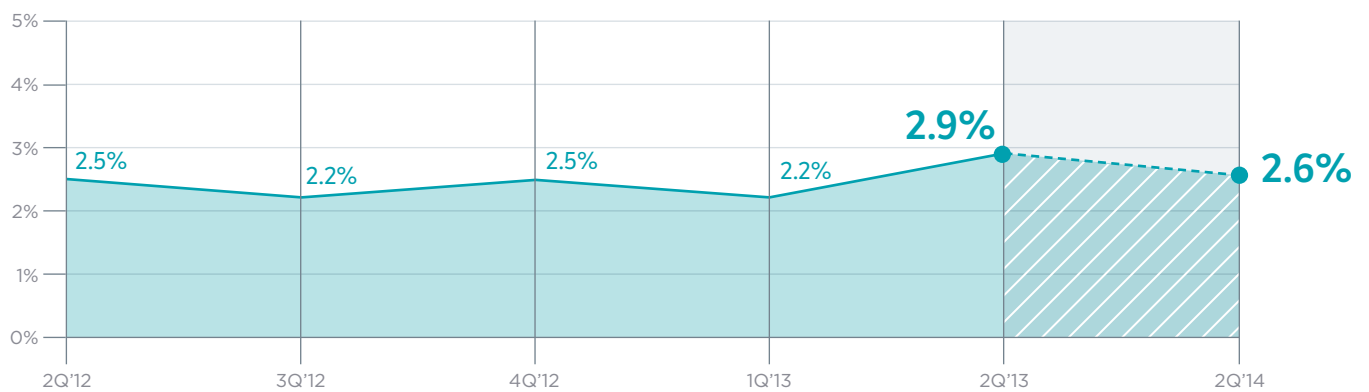
With nearly a third of the private sector GDP and employment in the U.S. coming from the middle market, such plans for job expansion should help boost the U.S. economy in the remainder of this year and into 2014.

Employment Growth By Segment

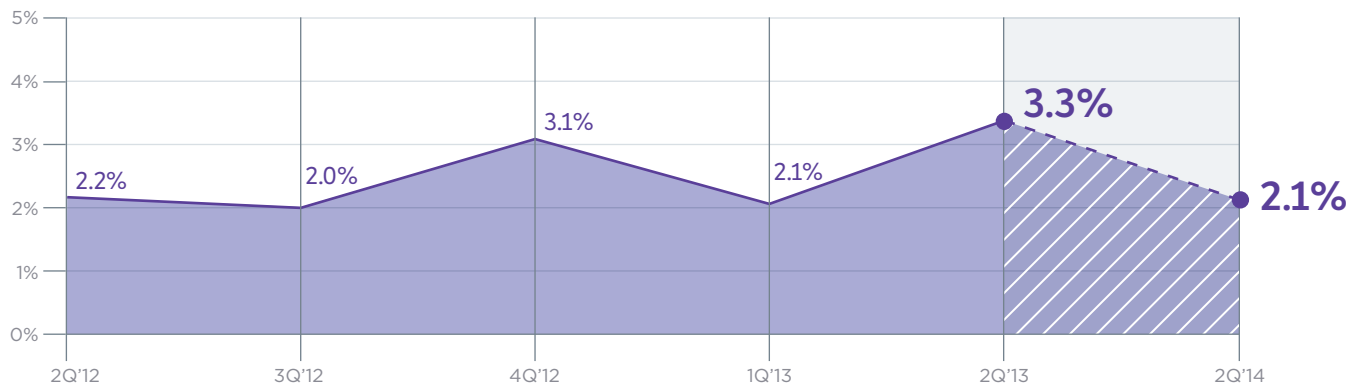
\$10MM—<\$50MM



\$50MM—<\$100MM



\$100MM—\$1B

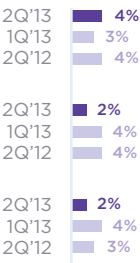
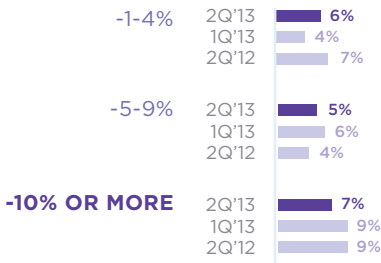
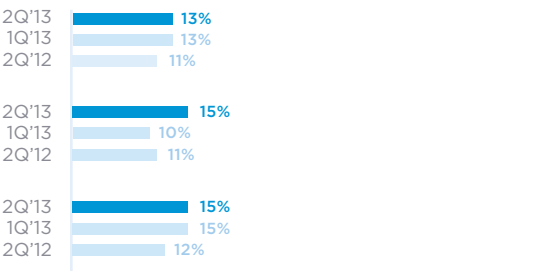
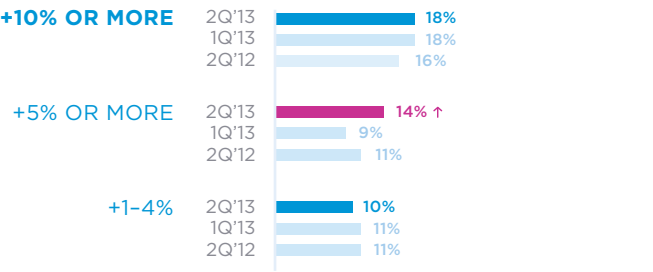


Employment Performance

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

PAST 12 MONTHS

NEXT 12 MONTHS



TOTAL GROWTH

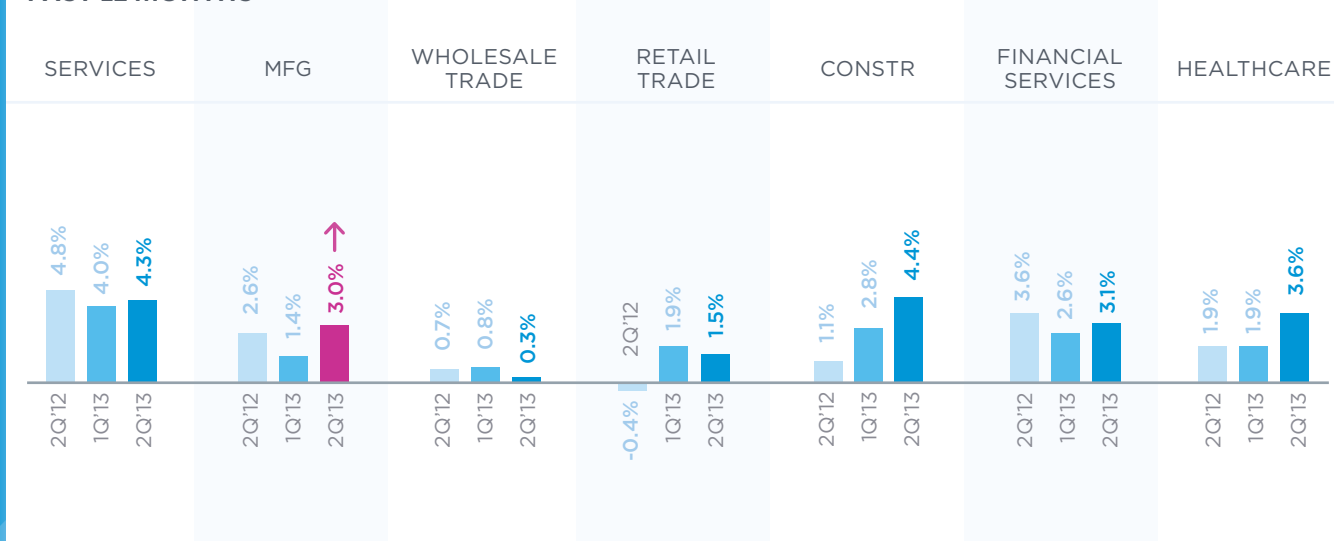
2Q 2.6%
1Q 2.2% 2Q/12 2.0%

2Q 2.5%
1Q 2.1% 2Q/12 1.8%

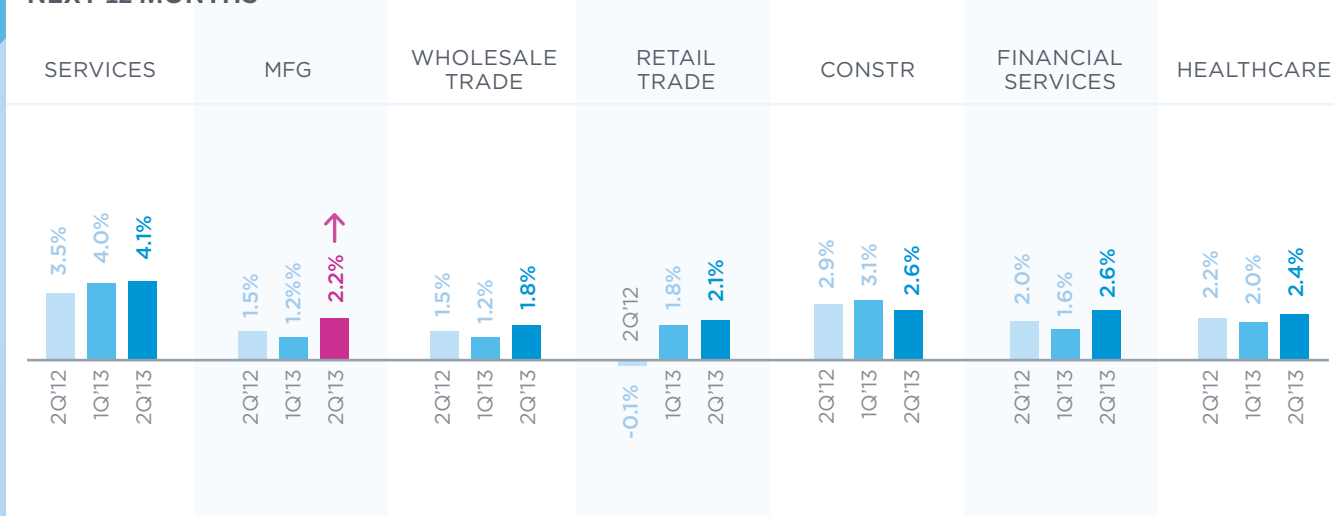
Employment Growth by Industry

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

PAST 12 MONTHS



NEXT 12 MONTHS



Confidence & Future Outlook

Financial decision makers at middle market companies of all sizes are gaining confidence in the economy – on a global, national and local basis.

The year-over-year increase in the number of respondents who say they are somewhat confident or confident in economic conditions reveals a notable shift in sentiment. The number surged to 48% for those asked in the second quarter of 2013 about their confidence on the global economy, more than double the 22% who responded in kind in the second quarter of 2012. For the U.S. economy, 63% of respondents said they were at least somewhat confident, up from 50% a year earlier; for the local economy, 79% are at least somewhat confident, a rise from 67% in the year-ago period.

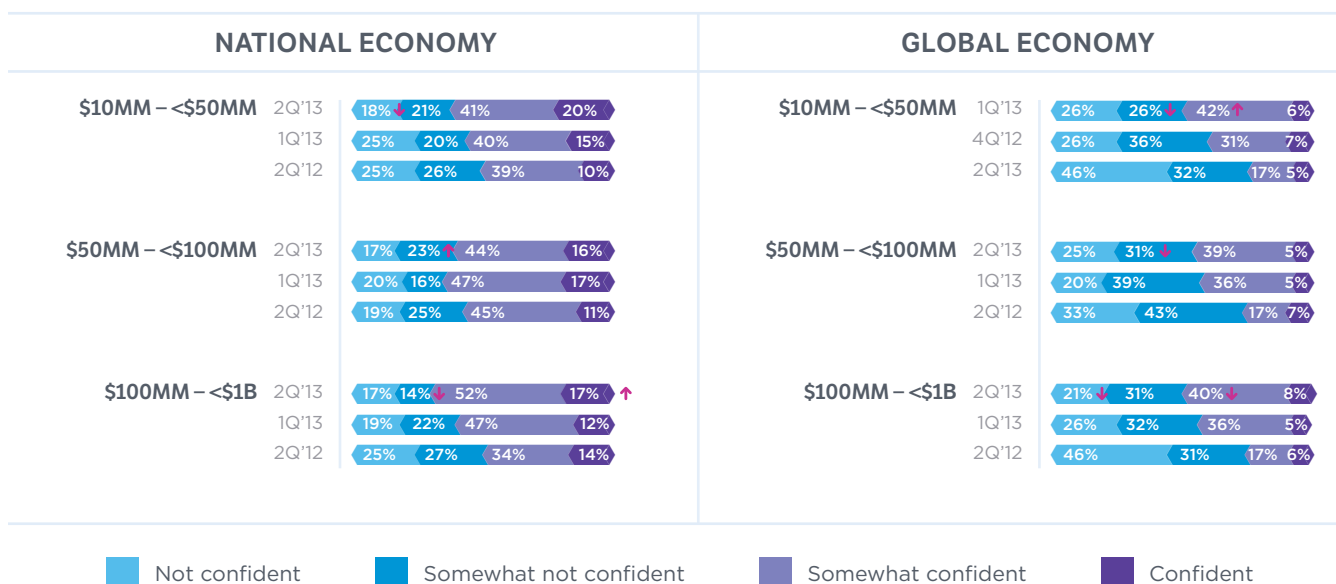
Within the middle market, companies of all sizes are showing buoyed optimism. Decision makers within the services, manufacturing, wholesale trade and construction sectors report particularly large increases in their confidence for global economic prospects. Leaders within the services sector fueled gains in confidence for the U.S. economy.

“While we have historically only served the U.S. market, we have grown our reach outside our borders as the clients we serve in the food industry have expanded their production with international sales.”

— CEO, Business Services, \$25MM annual revenues, 500 employees

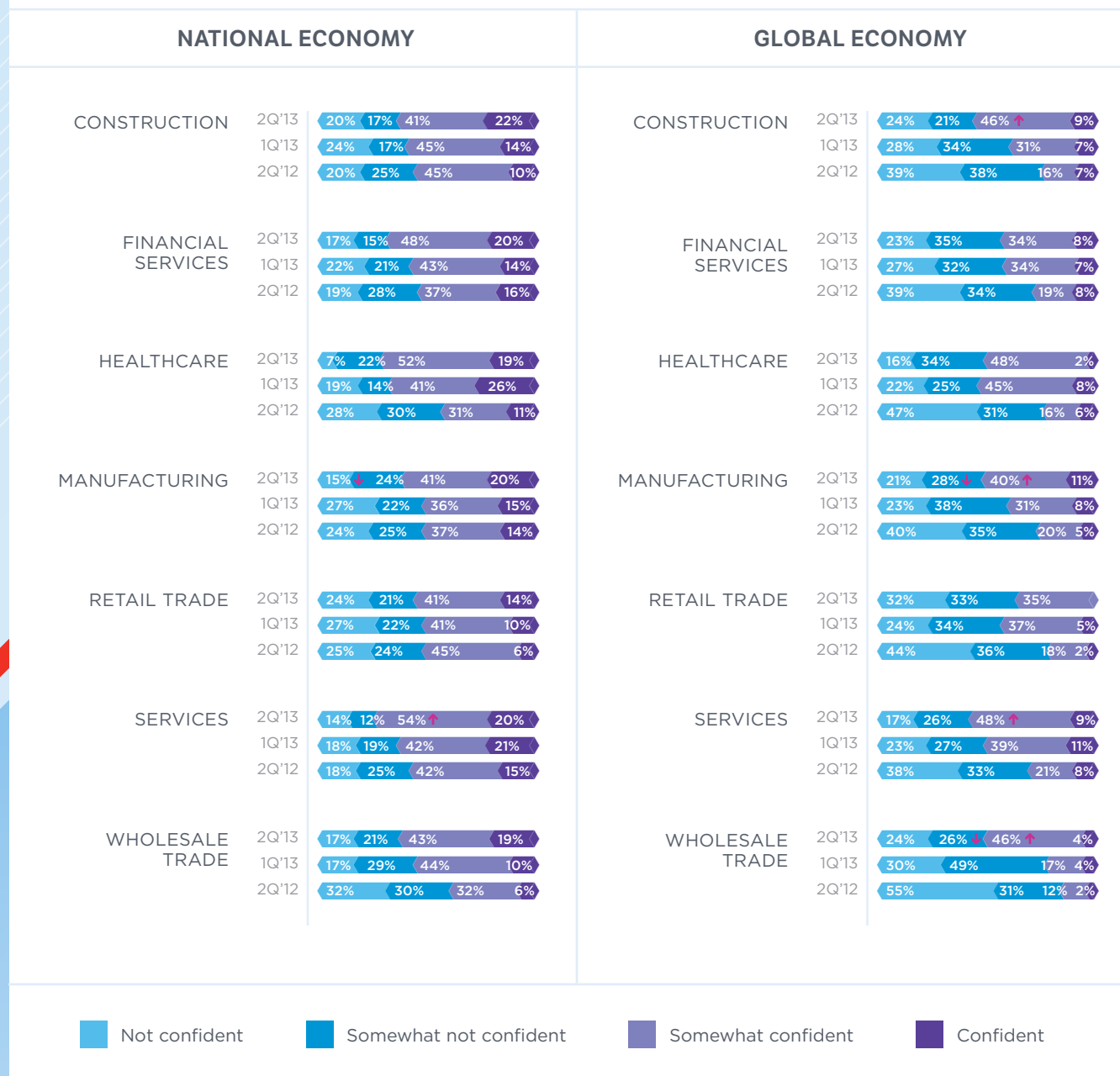
Confidence by Revenue Segment

Confidence in both the global and U.S. economy has been rising steadily over the past year across all revenue segments.



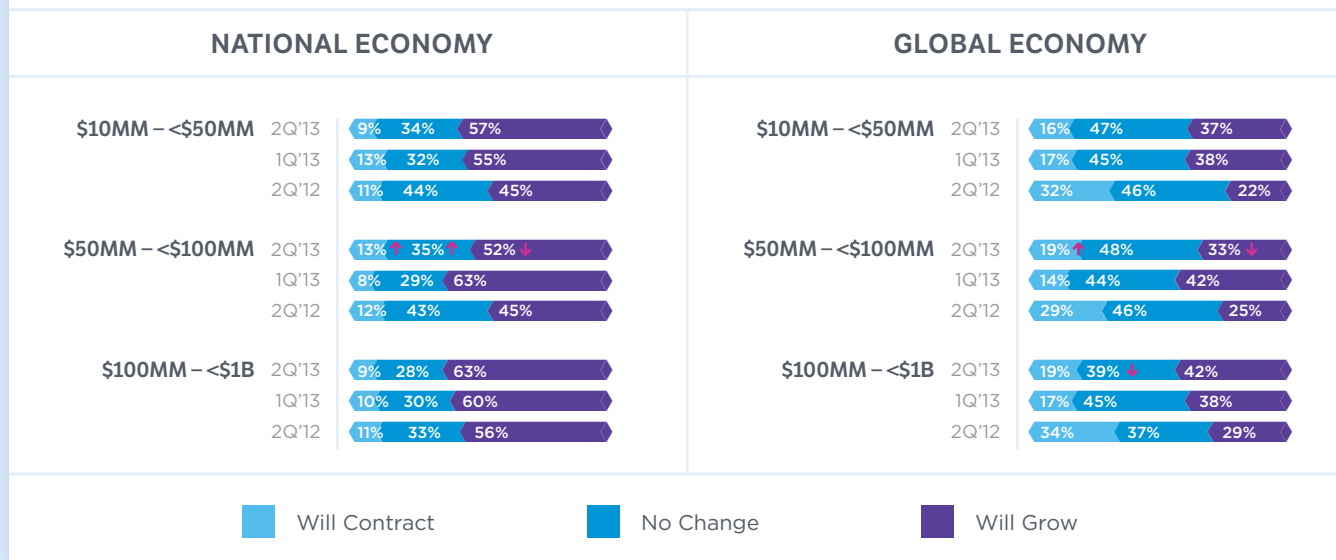
Confidence by Industry

Financial decision makers in the services, manufacturing, wholesale trade and construction industries exhibited especially big increases in confidence in the global economy.



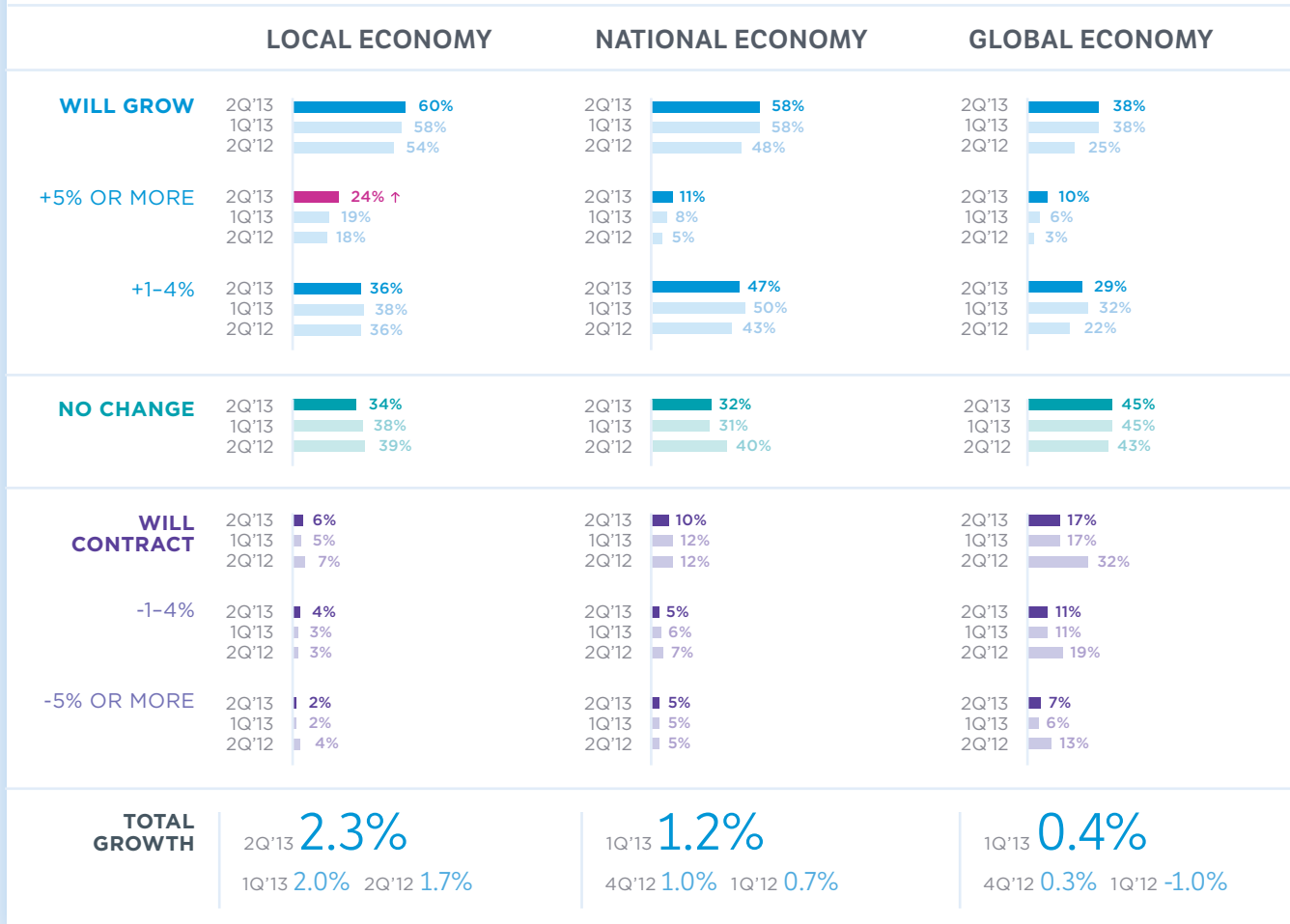
Economic Growth Outlook by Revenue Segment

The optimism for global and U.S. economic growth among small and core middle market leaders evident in the first quarter of 2013 has been somewhat tempered in 2Q 2013. Still, expectations for growth are higher than they were a year ago.



Economic Growth Outlook

Middle market leaders expect their firm to grow faster than the local, national and global economies.



Economic Growth Outlook by Industry

Leaders in the manufacturing sector have a higher expectation for U.S. economic growth than they did in 1Q 2013.



Challenges

“The uncertainty around healthcare reform has created a multitude of questions and doubts. And since regulations are still being drafted, there are very few, if any, answers. This climate is making it very challenging to budget and plan into the future.”

— CEO, Retail Trade, \$10MM annual revenues,
50 employees

“In the past year, we’ve experienced the highest percentage increase of benefits cost in our 12-year history.”

— CEO, Technology Services,
\$55MM annual revenues, 270 employees

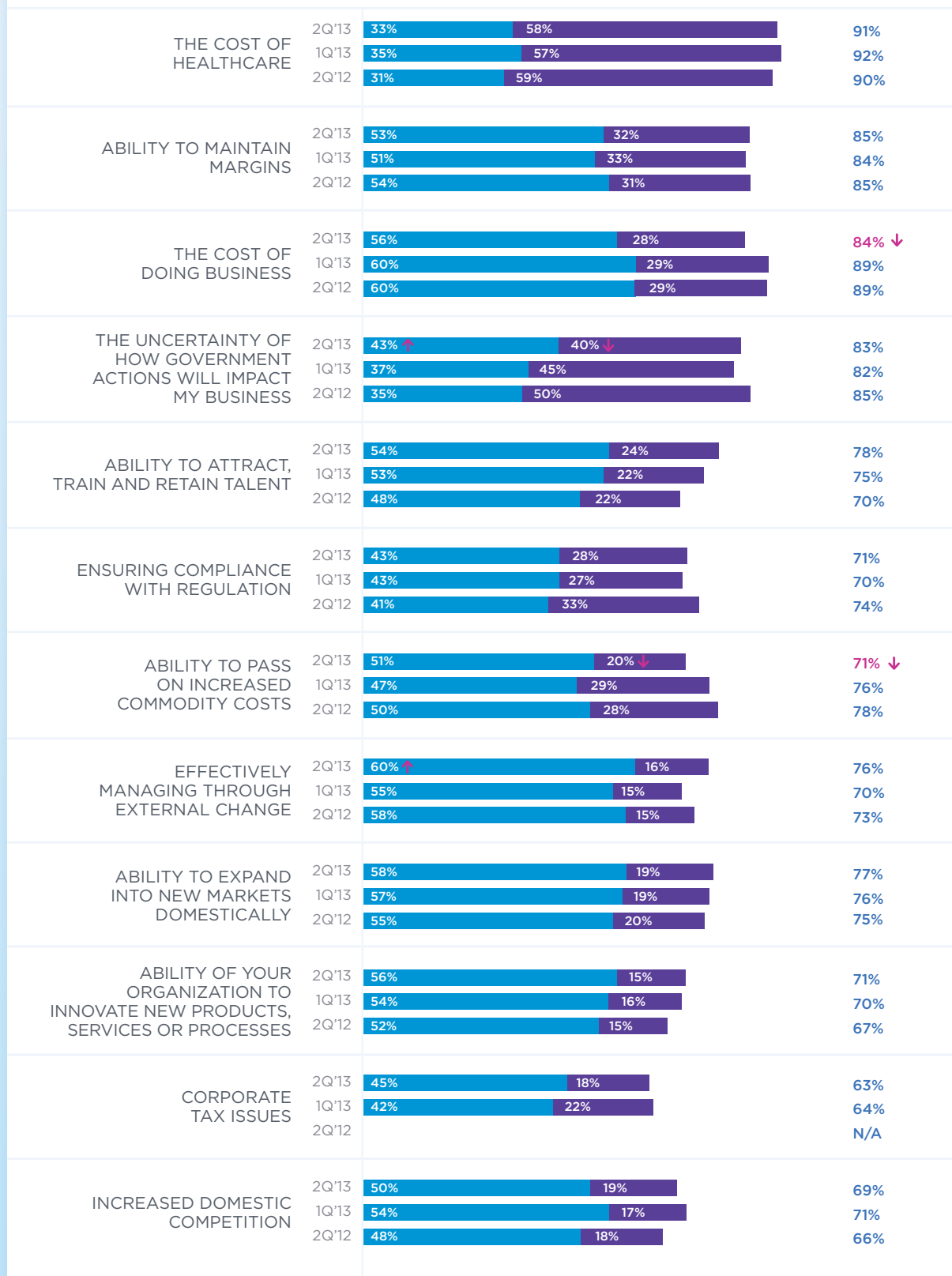
The cost of healthcare – even as the U.S. inches towards implementation of new legislation – persists as the major challenge facing middle market companies. Other concerns include the ability to grow revenue and maintain margins and the cost of doing business.

But 91% of all respondents cited healthcare uncertainty as their chief challenge, with more than 58% saying the topic was highly challenging. No other issue registered more than 40% of respondents citing it as a key issue.

The concern about healthcare has remained largely unchanged over the past year, cited more than 90% of the time as either highly or somewhat challenging over the past five quarters.

Key Challenges

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



Somewhat Challenging



Highly Challenging

Perspective

It appears the lasting effects of the Great Recession, officially from 2007 to 2009 but followed by many years of disappointingly low GDP growth, may finally be coming to an end. According to the Conference Board, consumer confidence in June was the highest in over five years. The Department of Commerce reports that new home sales in May were the highest since July 2008 and based on the S&P/Case Shiller Index, home prices hit the largest annualized gain in seven years in April. Durable goods orders and business spending are also remarkably up, also according to the Department of Commerce. Overall, the Federal Reserve is now forecasting real GDP growth up to 2.6% this year, with further expansion up to 3.5% in 2014. But, what will continue to drive this improvement?

Exports appear to be an unlikely source of growth. The Eurozone has contracted for the sixth consecutive quarter and China, the world's second largest economy, is slowing down, evidenced by manufacturing activity there contracting for the second month in a row. More ominously, Beijing is trying to constrain overly easy credit from banks, which may produce a credit crunch and dampen growth.

On the domestic front, the projected rate of revenue growth for large firms remains low at 1.2%, according to Bloomberg. There are signs that small firms are lagging in the economic expansion as well. In fact, confidence among small firms remains at recessionary levels.¹

It will come as no surprise to those who follow the middle market as to the engine behind this recovery. In the latest survey from the National Center for the Middle Market, the middle market continued to grow revenues at a healthy 5.8% in the last 12 months, and is expected to grow at 5.1% in the coming year. Employment in the middle market grew at 2.6%, and is expected to grow at 2.5% in the next 12 months. Economic confidence at all levels – global, national, and local—were the highest among the six quarterly surveys to date. The largest proportion of middle market managers in our six surveys (64%) would invest if given an extra dollar. Relative to other segments, these indicators are consistent with the middle market as the front runner of the recovery.

A NEW CHALLENGE FOR THE MIDDLE MARKET: A POSSIBLE CREDIT CRUNCH

Unfortunately, a number of challenges put the middle market and the economic recovery at risk. The latest problem to emerge is the likely return of costly credit. Recently, Fed Chairman Ben Bernanke commented that the “taper off” of quantitative easing would begin from December 2013 and end by mid-2014. The Chairman’s remarks had an immediate market effect, as rates on 10-year Treasuries spiked to a two-year high, and the stock market dropped significantly. Middle market firms in particular are adversely affected by tight credit markets. They have neither government subsidized schemes or the influence of large firms to command more affordable credit. Although the Fed faces an understandable dilemma, it might reconsider its position and remove the stimulus only after the economic recovery is firmly in place.

A LONG-STANDING TOP CONCERN FOR THE MIDDLE MARKET: HEALTHCARE COSTS

There are other long-standing problems that hinder growth in the middle market, healthcare costs in particular. Healthcare costs have been consistently ranked as the top challenge for middle market managers in every quarterly survey since the beginning of 2012. In past surveys, it was pointed out that the Patient Protection and Affordable Care Act (PCACA, but popularly called Obamacare) may have some unintended negative business consequences. Middle market managers have said that higher healthcare costs will dampen investment and reduce employment. Now, through follow-up investigation, we further know that the managers who worry about adverse effects of healthcare reform also predict lower revenue growth rates. Such managers also report lower confidence at all levels: global, U.S., and local economies. The recently announced delay in the enforcement of a major PCACA requirement that all employers with more than 50 employees provide coverage to their workers means more companies will have time to consider the best strategies for implementation.

1. “Small firms to keep lagging back in U.S. Expansion: Economy,” by Alex Kowalski & Jeanna Smialek, Bloomberg.com, Jan. 14, 2013.

SO, WHAT CAN MIDDLE MARKET FIRMS DO TO SPUR GROWTH?

With relatively little influence on government policy, middle market firms have had to historically “grin and bear it” when it comes to the consequences of government action. In contrast, small firms have formal advocacy in the form of the Small Business Administration, and large firms have greater resources to support lobbying efforts and other measures. There are, however, other avenues for middle market firms to drive growth and The National Center for the Middle Market has been highlighting such strategies for growth. In its research on the characteristics of so-called Growth Champions (firms with sustained 10% revenue growth), globalization has emerged as an effective path toward increasing revenues as well as employment. The latest MMI survey findings show that middle market firms with some international operations (606 respondents) are projecting revenue growth for the next 12 months at 5.6%, while those with operations entirely within the U.S. (394 respondents) are expecting an average revenue growth rate of 4.3%. In terms of employment projections, the corresponding rates of growth are 2.7% versus 2.3%, respectively. The recent experience over the last 12 months, in terms of both revenue and employment growth, also shows greater growth among firms with international operations. This is particularly impressive in light of economic challenges in Europe and China.

The U.S. economy is finally in a meaningful recovery mode, and middle market firms are major players in this recovery. Research from the National Center for the Middle Market offers prescriptive strategies for growth. In fact, these strategies do not depend on being in certain industries or geographies. Rather, they depend on the actions of the firm. Specifically, organizations with superior customer focus, management culture, talent management, investment in innovation, and geographic expansion have demonstrated sustained high growth in the past, and should be poised for future success.





**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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