

4Q 2013

MIDDLE MARKET INDICATOR



NATIONAL CENTER FOR
THE MIDDLE MARKET

In Collaboration With



THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS



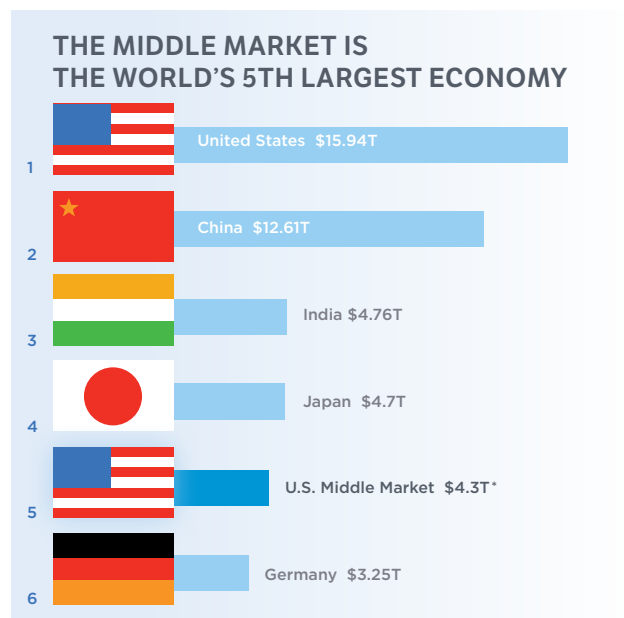
GE Capital

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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 nearly 200,000 U.S. middle market businesses that represent one-third of private sector GDP, employing approximately 44.5 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 nearly 200,000 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

The U.S. middle market continued its revenue and employment growth during the fourth quarter of 2013, though with a slower pace that could remain tempered during 2014. Certain sectors within the middle market – manufacturing and construction, for example – wrapped up 2013 in strong fashion; that contrasts with retailers and healthcare providers which reported slowing growth and diminished prospects looking forward. Confidence in the global economy has improved, while it has leveled off both for the U.S. and local outlook. Meanwhile, a majority of middle market leaders said they are holding back on hiring and putting capital to work because they lack clarity on federal regulations.

More than half of middle market companies – defined as those with annual revenues between \$10 million and \$1 billion – reported improved company performance in 2013. Overall there was a slight decline in the number of middle market companies reporting improved performance, 56% down from 62% three months earlier.

Revenue grew at 5.0% in the fourth quarter, which marks the slowest rate of increase over the past four quarters and a notable decline from the year earlier rate of 7.0%, when companies were rebounding from the recession. Those results, however, outpace the performance of the broader market by a wide differential – underscoring the middle market's stability and its critical role as a driver of the U.S. economy. Analysts anticipate a meager 1.0% increase in revenue for the S&P 500 in the fourth-quarter (flat to the 0.9% estimated at the beginning of the period and a fraction of the growth expected from the middle market).¹

Employment gains remain steady, as the middle market continues to generate jobs. Roughly four in ten companies expanded their workforce in the quarter. Employment at middle market companies increased 2.5% in the period, in line with gains over the past year.

Prospects for future growth have stabilized, and are lower than earlier in the year as middle market executives face strong headwinds. Healthcare costs, domestic regulations and the ability to generate revenue and maintain margins dominate concerns. Almost three of five executives say that federal policy uncertainty has impacted their business planning.

Looking ahead, middle market companies anticipate revenue growth of 4.3%, a decline from the 5.2% estimated growth a year earlier and 5.0% reported growth for the previous twelve months. The subdued outlook, impacted mainly by the retail sector, still outpaces broader market expectations.

“We would invest in strategies or opportunities to expand our footprint with franchisees as well as in tools and technologies that supplement our growth.”

— CFO, Services Industry, \$220MM annual revenue, 3,000 employees

¹http://www.factset.com/websitefiles/PDFs/earningsinsight/earningsinsight_12.20.13E

Key Findings:



COMPANIES REPORT CONTINUED PERFORMANCE GAINS:

Revenue for middle market companies increased during the fourth quarter of 2013 with 56% of companies reporting improvements, down slightly from 62% in the third quarter and the fourth quarter of last year, but in line with results earlier in the year. The mean revenue growth declined to 5.0%, extending a year-long slide. Smaller middle market companies – those with revenue between \$10 and \$50 million – drove the trend, with only half reporting improvement, down from 59% three months ago.

Companies continue to expect improvement in the coming year with 57% projecting revenue growth, leveling off from 60% last quarter. These companies expect increases of 4.3%, down from 5.2% last year, but roughly the same as the third-quarter forecast.



EMPLOYMENT GROWTH STABILIZES:

In the fourth quarter, 39% of middle market companies said they added workers, consistent with results over the previous four quarters. Companies reported mean job growth of 2.5%, down from 2.7% a year ago, but up from 2.2% during the first quarter. Large middle market companies – those with more than \$100 million in revenue – added workers at an average rate of just over 3.0%.

Looking ahead, the middle market expects 2.2% job growth in 2014. Of manufacturers, 48% expect increased hiring, up from 38% a quarter ago. On the other hand, retailers expecting to increase hiring dropped to 36% in the fourth quarter, down from 51% in three months and only 29% of healthcare providers expect to increase hiring, down from 49% last quarter.



CONFIDENCE LANDSCAPE HAS SHIFTED:

The confidence outlook has changed noticeably in the past year with increased optimism in the global economy and a leveling-off of confidence in both the local and U.S. economies. Only 16% of respondents reported no confidence in the global economy in the fourth quarter of 2013, less than half the 34% a year ago. In the period, 56% said they were at least somewhat confident in global prospects, up from 33% a year earlier. Confidence in the U.S. economy remained steady – 64% of respondents expressed some degree of confidence in domestic prospects in the fourth quarter of this year, compared with 62% a year earlier. Confidence in the local economy improved marginally; 76% expressed at least some confidence compared with 71% a year earlier.



CAPITAL INVESTMENT, HIRING RESTRAINED BY POLICY UNCERTAINTY:

A majority of middle market companies said that uncertainty regarding government policies is impeding their ability to grow and their willingness to hire and spend. Almost three in five (58%) of all middle market companies say that federal policy uncertainty has impacted their business planning, with 63% of those respondents saying they are less likely to hire new workers and more likely to trim expenses as a result, and 56% saying they are less likely to make capital investments.

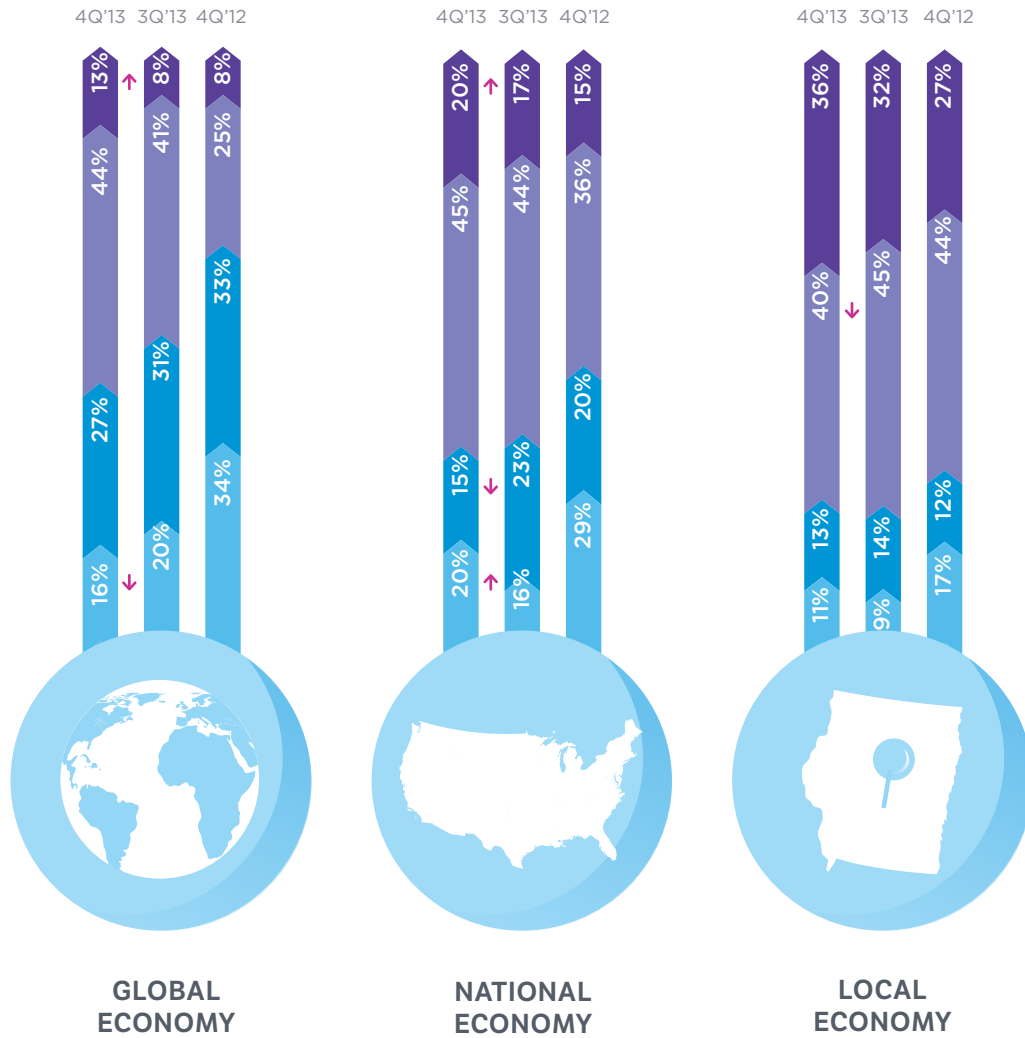
Middle market executives also cited high corporate taxes and a lack of tax incentives as impediments to growth. Nonetheless, 64% of respondents said they would spend rather than save excess cash, returning to levels last seen in the second quarter of 2013, the highest level in the past five quarters.



CHALLENGES PERSIST:

The challenges facing middle market companies remained fairly static. The impact of healthcare legislation continues to be the largest concern, with 88% of all respondents saying that healthcare costs are at least somewhat challenging and more than half saying they are highly challenging. The ability to grow revenue and maintain margins follow closely behind as major challenges.

Economic Confidence Indicators



■ Not confident
 ■ Somewhat not confident
 ■ Somewhat confident
 ■ Confident

Note: Arrows indicate significant difference compared to immediate previous time period.

Growth Indicators

Revenue Growth

MIDDLE MARKET

PAST 12 MO.

4Q'13 **5.0%**

3Q'13 5.5% 4Q'12 7.0%

NEXT 12 MO.

4Q'13 **4.3%**

3Q'13 4.4% 4Q'12 5.2%

Employment Growth

MIDDLE MARKET

PAST 12 MO.

4Q'13 **2.5%**

3Q'13 2.8% 4Q'12 2.7%

NEXT 12 MO.

4Q'13 **2.2%**

3Q'13 2.1% 4Q'12 2.3%

S&P 500

PAST 12 MO.

4Q'13 **1.0%**

3Q'13 2.6% 4Q'12 2.9%

NEXT 12 MO.

4Q'13 **0.8%**

3Q'13 1.0% 4Q'12 3.5%

ADP (PAST 12 MO.)

LARGE CORP.

4Q'13 **2.3%**

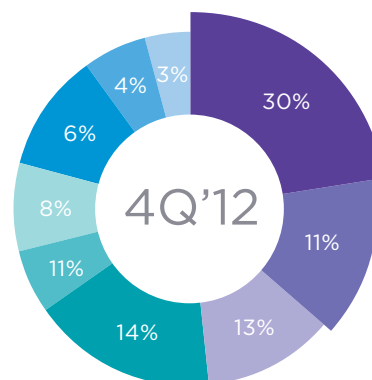
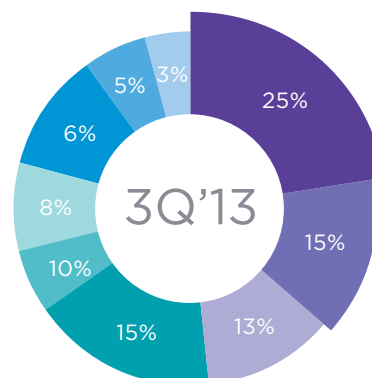
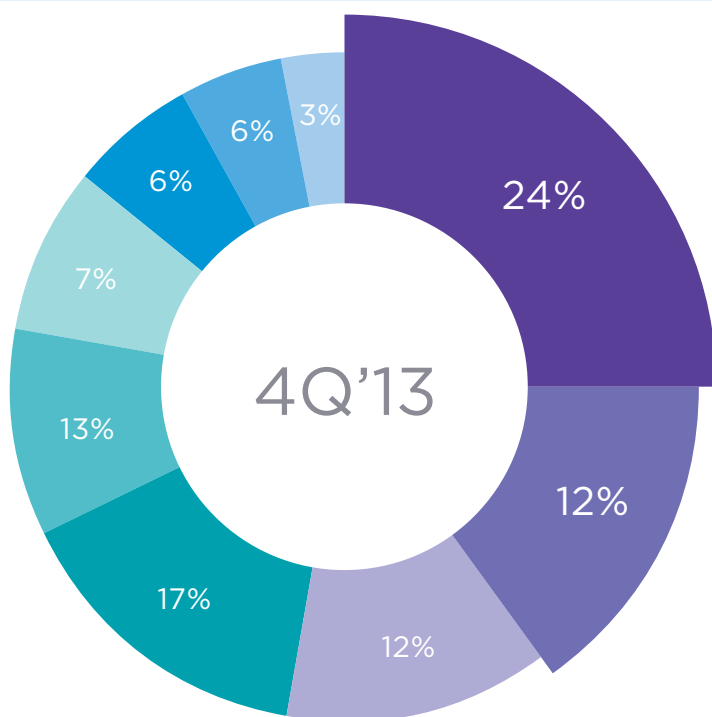
3Q'13 2.4% 4Q'12 2.3%

SMALL BUS.

4Q'13 **2.0%**

3Q'13 1.8% 4Q'12 1.6%

Incremental Investment Allocation



Recent & Expected Growth

A majority of middle market companies reported improved revenue growth from a year earlier and more than half anticipate improved results in 2014. Of the companies surveyed, 56% said business in the period improved. That's below the 62% that reported improved growth in the third quarter. Smaller middle market firms dragged down results, with only 50% reporting improved revenue in the quarter, down from 59% in the three months. Only one in ten middle market companies said that business deteriorated, unchanged from the prior period.

Mean revenue growth decelerated to 5.0% in the quarter, from 5.5% in the third period. Retailers dragged down results. While 77% of retailers reported year-over-year revenue gains in the third quarter, only 54% reported such gains in results this period. Fewer healthcare companies reported improved year-to-year revenue gains in the period; (53% in the fourth quarter vs. 64% in the third).

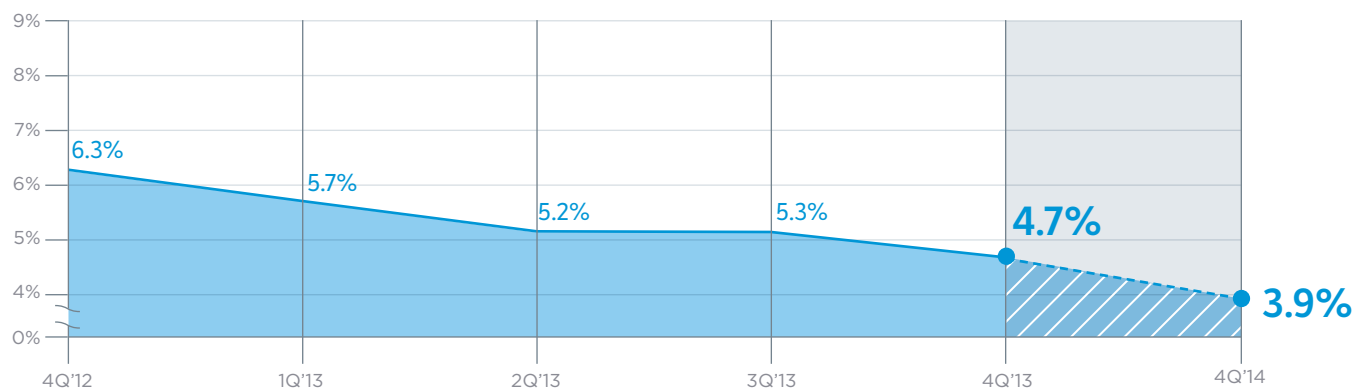
Moving forward, prospects for future revenue growth appear to have leveled off, after slipping in the third quarter. The middle market anticipates 4.3% revenue gains, down marginally from 4.4% in the last quarter. Some 57% of companies expect revenue to grow, down slightly from 60% a quarter earlier. Smaller middle market firms expect to bear the brunt of the deterioration in revenue growth, with only 51% anticipating growth, down from 58% in the third quarter. These companies also only expect revenue to increase 3.9% in the year ahead. That's a sharp drop from 5.0% in the fourth quarter of 2012 and 4.4% three months ago.

Disappointing growth expectations in the retail trade sector, and to a lesser extent healthcare, are driving the anticipated lower revenue expectations. Fewer than half of retailers, or 49%, expect revenue to grow in 2014; that's down from 72% in the third quarter. Overall, retailers expect revenue growth of 3.7%, down from 4.6% three months earlier and down from 5.2% a year ago.

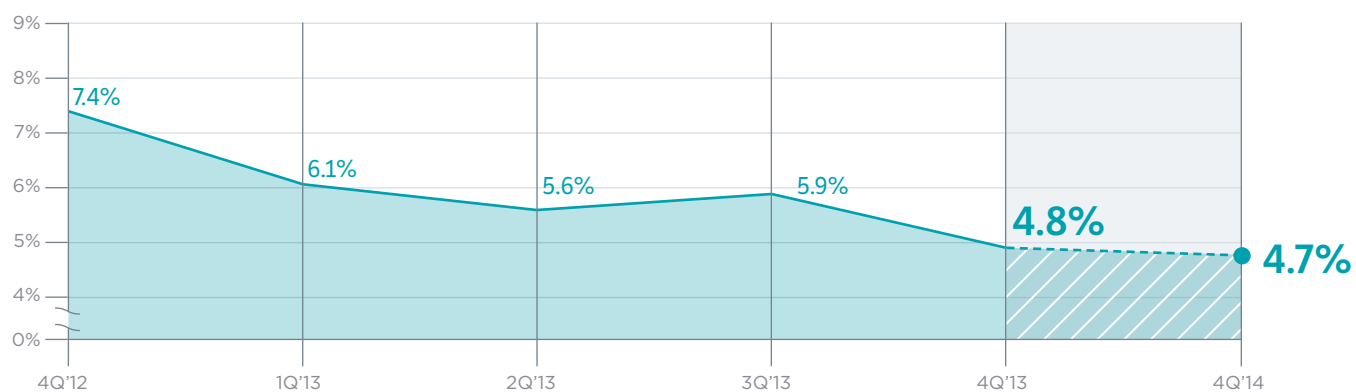
Healthcare providers anticipate revenue growth will decelerate to 3%; a year earlier this group reported expectations for growth of 4.1%. The percentage of healthcare companies forecasting revenue gains slid to 46% from 55% in the third quarter. On the flip side, construction companies expect revenue to grow 5.7%; just a quarter ago they had forecast gains of 3.7%. Similarly, financial service companies said they see revenue increasing 4.7%, up from 4.1% in three months.

Revenue Growth By Segment

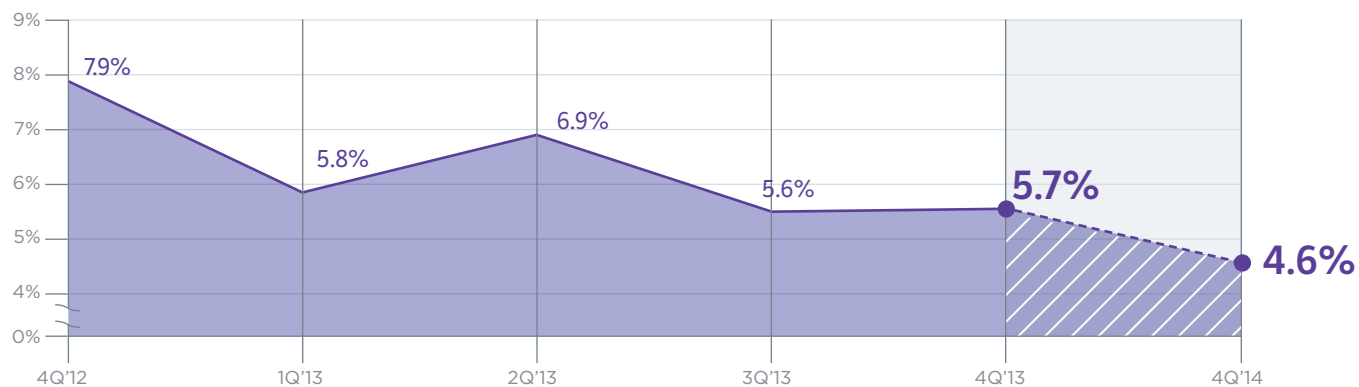
\$10MM—<\$50MM



\$50MM—<\$100MM



\$100MM—\$1B



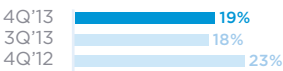
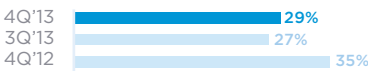
Revenue Performance

Some erosion in revenue growth is evident over the last few quarters.

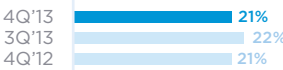
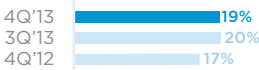
PAST 12 MONTHS

NEXT 12 MONTHS

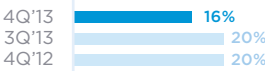
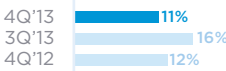
+10% OR MORE



+5% OR MORE



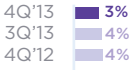
+1-4%



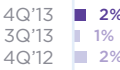
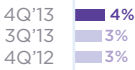
NO CHANGE



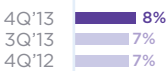
-1-4%



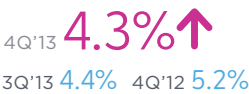
-5-9%



-10% OR MORE



TOTAL GROWTH



Revenue Performance by Industry

The number of retail trade firms reporting increased revenue vs. a year ago dropped significantly and now stands at less than half.

PAST 12 MONTHS



NEXT 12 MONTHS



Recent & Expected Growth

Employment

Despite tempering revenue growth forecasts, the middle market does not expect to slow the pace of hiring. Of the survey respondents, 38% said they will hire workers, barely down from 40% in the prior quarter. Only one in ten companies said they would reduce their workforce. The mean total employment growth forecast ticked up slightly to 2.2% from 2.1% in the fourth quarter, remaining in a narrow 2.1-2.5% range throughout the year.

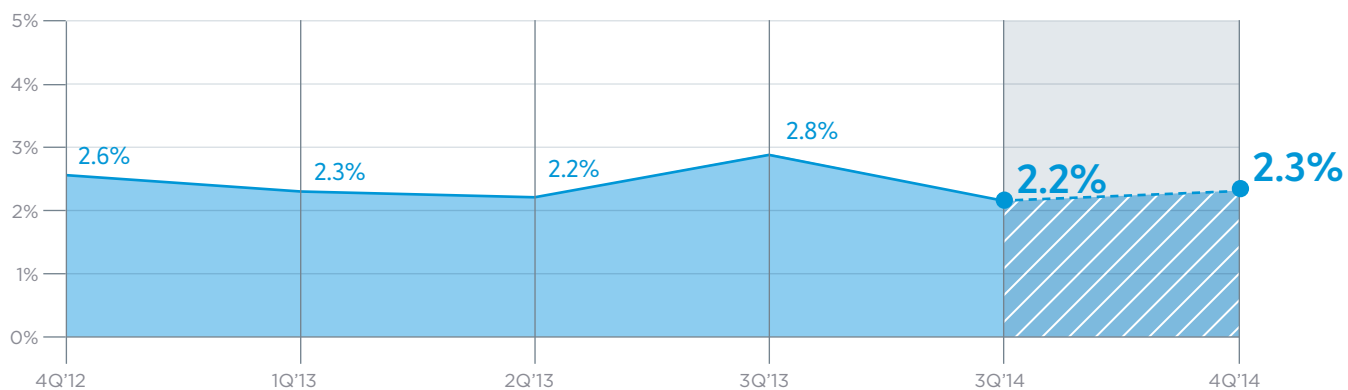
Expectations for job growth are fairly consistent across all sizes of middle market firms.

The hiring expectations of respondents in the manufacturing sector surged dramatically in the period. While only 38% of manufacturers last quarter said they planned to increase hiring, 48% expressed a similar sentiment this quarter. That offsets a steep decline in hiring expectations among retailers, where only 36% of respondents anticipate hiring, down from 51% a quarter ago.

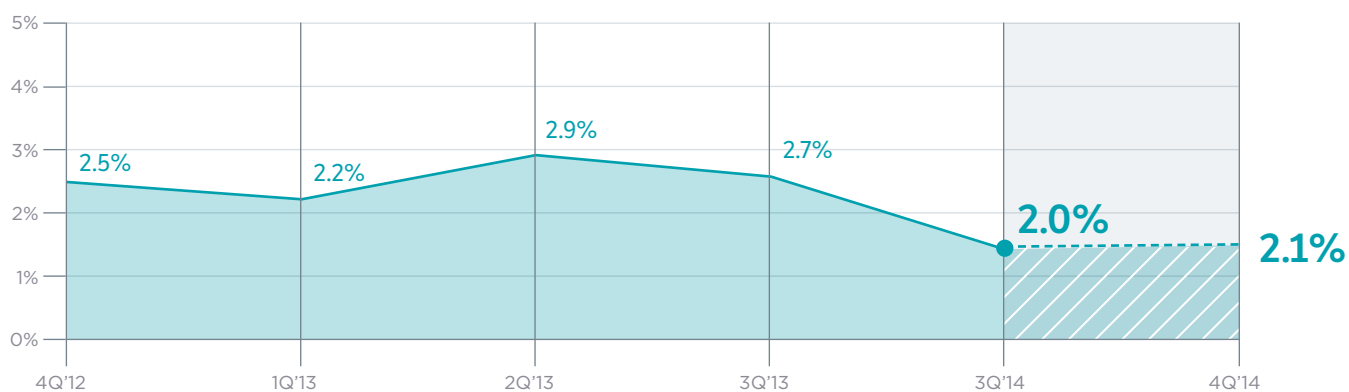
With almost a third of the private sector GDP and employment in the U.S. coming from the middle market, a slowdown in job expansion could prevent the U.S. economy from accelerating in 2014. The stabilizing employment outlook, even in the face of a decelerating revenue outlook, bodes well for job creation.

Employment Growth By Segment

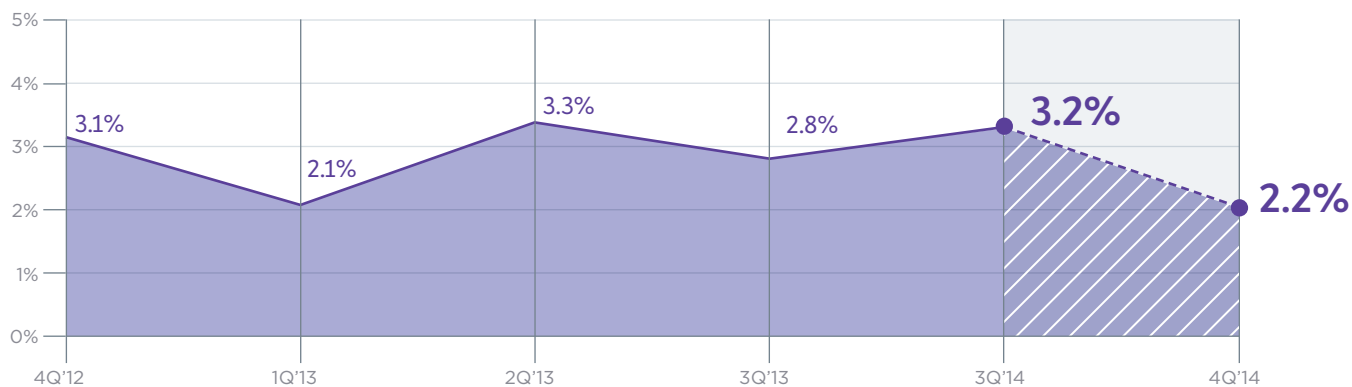
\$10MM—<\$50MM



\$50MM—<\$100MM



\$100MM—\$1B

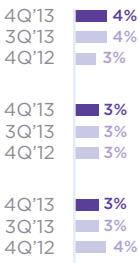
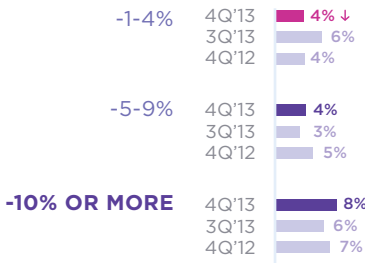
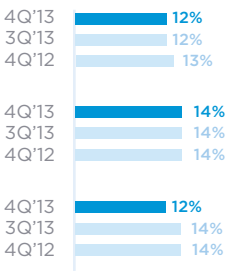
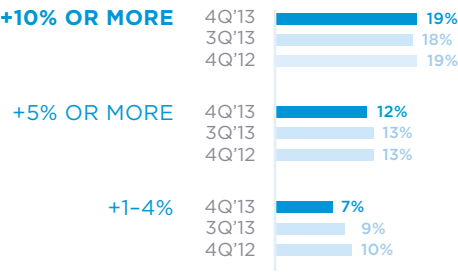


Employment Performance

Employment growth is stable over the past year.

PAST 12 MONTHS

NEXT 12 MONTHS



TOTAL GROWTH

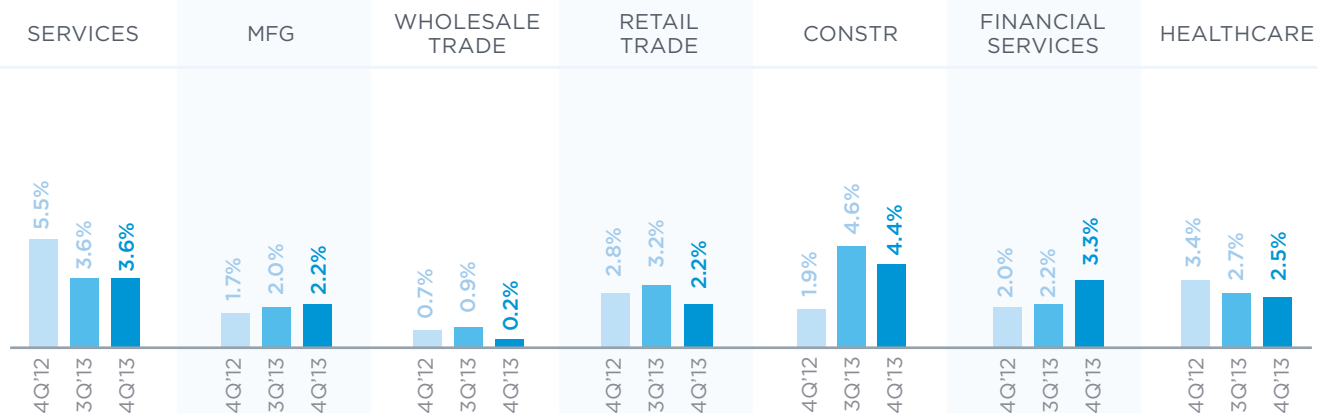
4Q'13 **2.5%**
3Q'13 2.8% 4Q'12 2.7%

4Q'13 **2.2%**
3Q'13 2.1% 4Q'12 2.3%

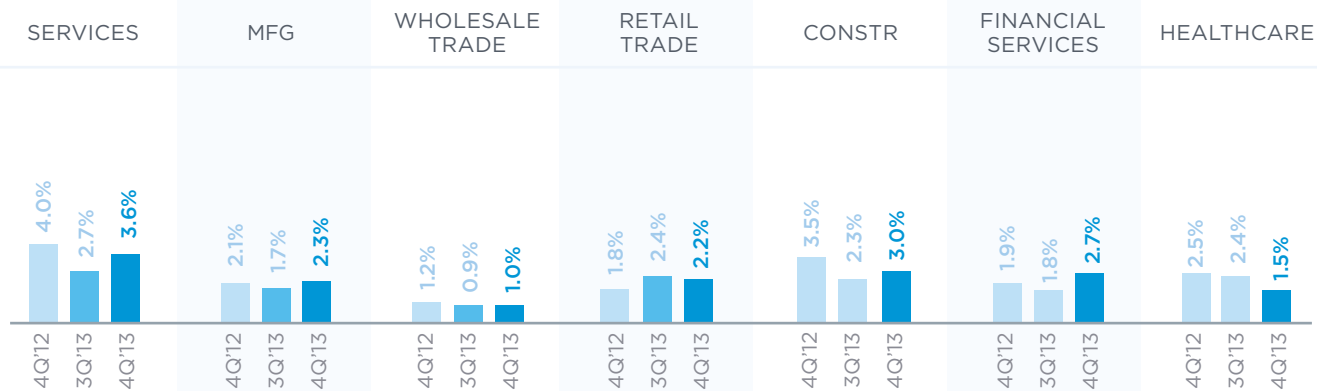
Employment Growth by Industry

Employment growth is stable across industries.

PAST 12 MONTHS



NEXT 12 MONTHS



Confidence & Future Outlook

Financial decision makers at middle market companies increasingly are confident in the global economy. A year ago, more than two-thirds of respondents were at least partially not confident about the global economic outlook. That sentiment has almost completely reversed, with 56% of executives saying they are at least somewhat confident in their global outlook.

However, there was a 25% increase in just three months in the number of executives who said they lacked confidence in the U.S. economy. The percentage of executives at least partially confident in the domestic economy overall increased slightly from 62% in the third quarter to 64% in the fourth. On a local level, there appears to be some stability in confidence, with 76% of middle market executives at least somewhat confident in the fourth quarter, compared with 77% in the prior quarter and 79% in the period before that.

Retail trade respondents had a far less negative outlook on the global economy. Only 12% of retailers said they lacked confidence in the global economy during the fourth quarter, down from 31% three months earlier.

Wholesalers had an increasingly negative outlook for the U.S., with 28% of respondents reporting they are not confident in the period, up from 11% in the third quarter.

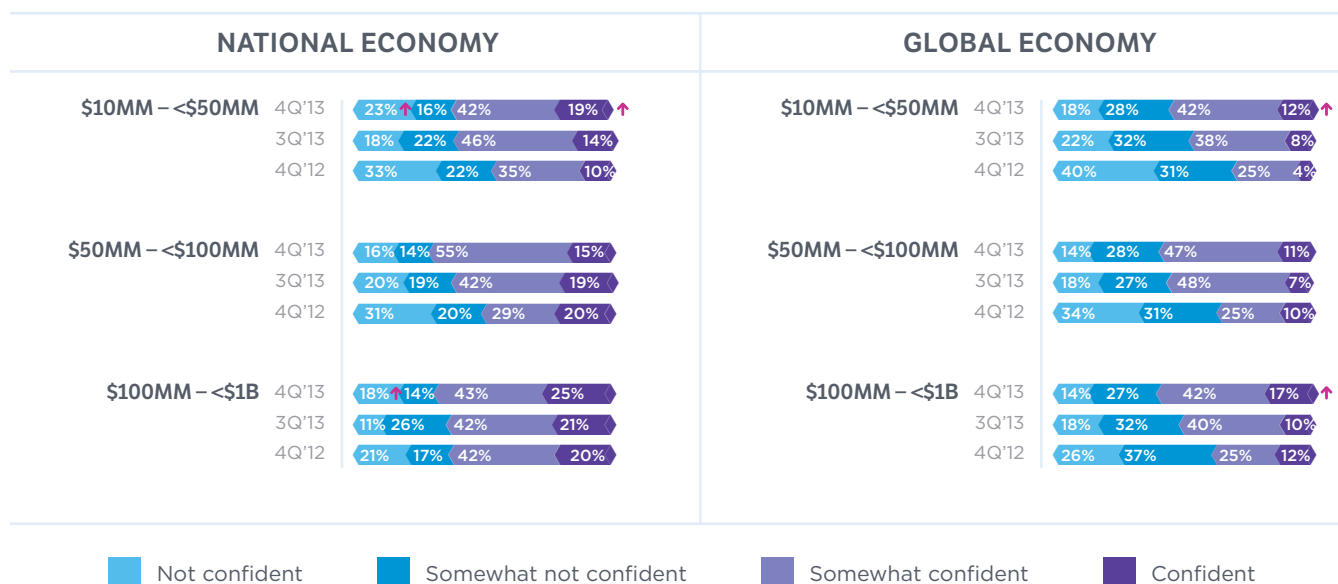
Growth expectations of the US economy are deteriorating among leaders of the smaller middle market firms, with 51% reporting in the fourth quarter that the U.S. economy will grow, down from 59% in the past three months.

“We anticipate top-line growth of 20% and hiring close to 15%. We do have momentum in spite of Washington and the economy as we have re-engineered the organization and executed on opportunities successfully.”

— CFO, Services, \$220MM annual revenue, 3,000 employees

Confidence by Revenue Segment

Confidence in the global economy is higher among all revenue segments.



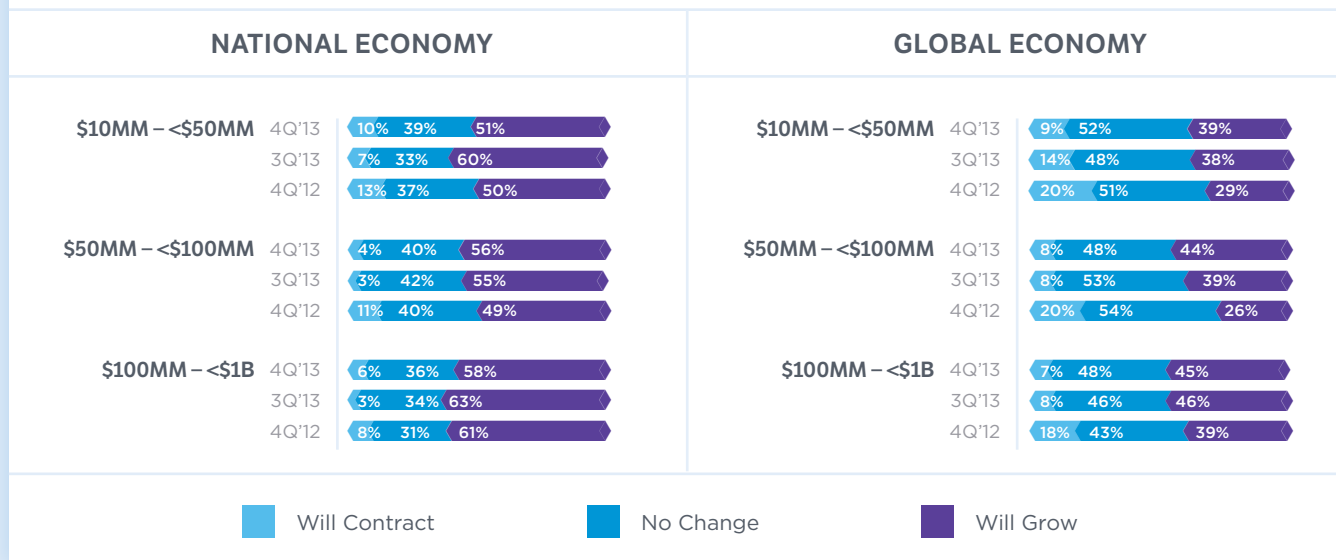
Confidence by Industry

The proportion of retail trade business leaders with a negative outlook on the global economy has decreased significantly.



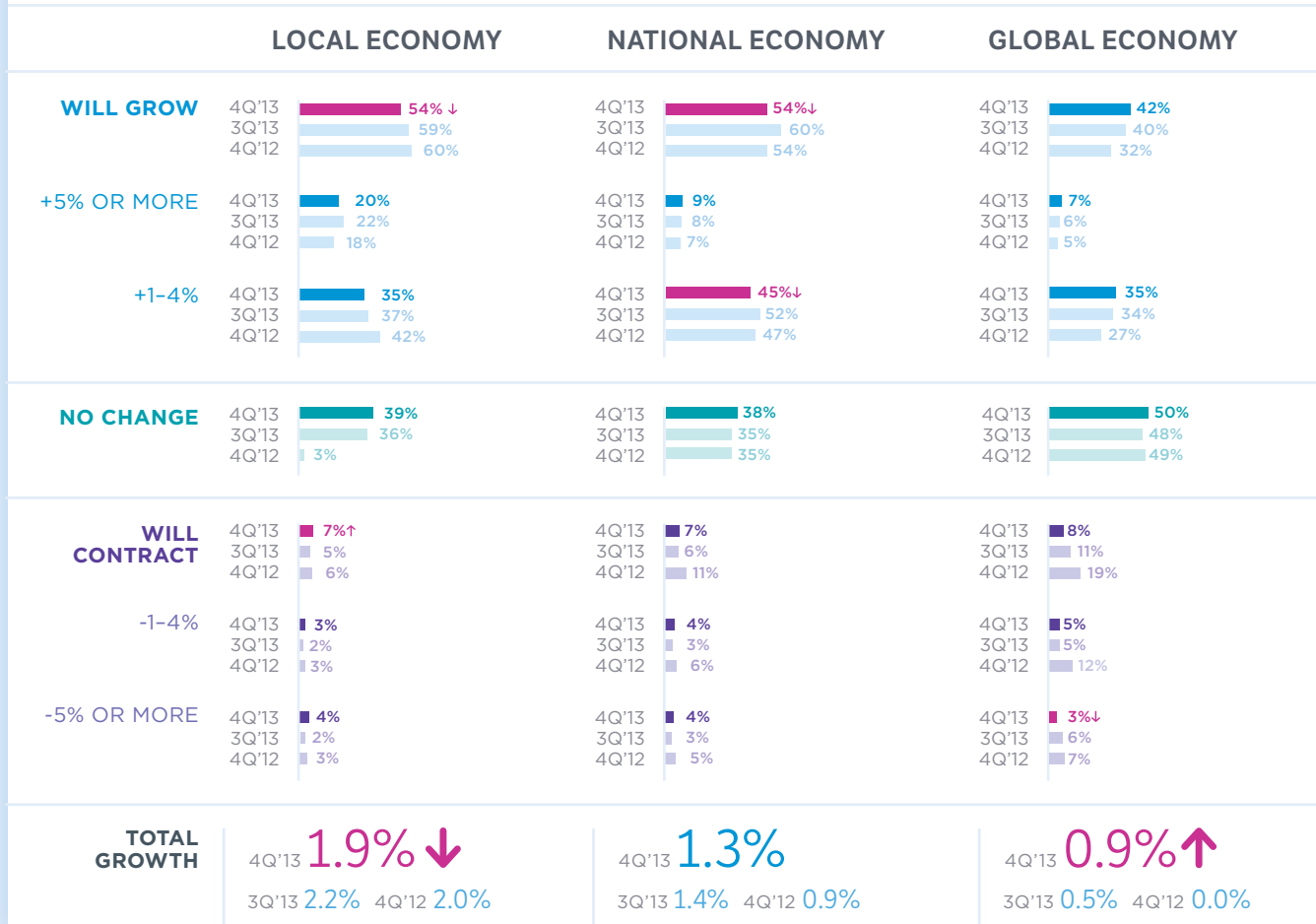
Economic Growth Outlook by Revenue Segment

Growth expectations of the U.S. economy are deteriorating among leaders of smaller MM firms.



Economic Growth Outlook

Despite decreasing expectations of the local economy growth rate, MM leaders expectations' for their own business growth remains strong.



Economic Growth Outlook by Industry

Global and U.S. economic growth expectations are stable across industries.



Challenges

The most challenging issue to middle market executives remains healthcare costs, even as the U.S. enters into the implementation stage of the Affordable Care Act. Almost nine in ten executives cited the cost of healthcare as somewhat or highly challenging, extending its ranking as the No. 1 concern to more than a year. More than half of all respondents cited healthcare as highly challenging; it was the lone concern in which more than half of respondents said the issue was highly challenging.

The ability to grow revenue and maintain margins and the cost of doing business follow as other major concerns with 86% of all respondents citing both.

For the first time the Middle Market Indicator survey asked respondents about the impact of federal policy and 58% responded that uncertainty about federal policy impacts their business planning and almost two-thirds of those respondents said it has resulted in holding off on hiring, cutting back on expenses like travel and bonus, and shelving plans to invest their capital.

Middle market leaders expressed overwhelming disapproval of the rollout of the ACA, with 79% of respondents saying they disapproved of the President's rollout of the healthcare plan with most respondents (85%) saying the rollout was poorly handled and 66% disagreeing with having the individual mandate provision.

Debt ceiling concerns also continue to cast a shadow over the middle market with most respondents anticipating a serious negative impact on their business if the government defaults on its debt. The most likely outcome relates to decreased confidence in the creditworthiness of the U.S. economy.

Access to capital has remained stable overall. For healthcare providers and construction firms, the restrictive lending environment in the third quarter appears to have eased, with only half of respondents in those sectors saying that lending is more restrictive, down from 74% and 68%, respectively, in the third quarter for healthcare and construction respondents.

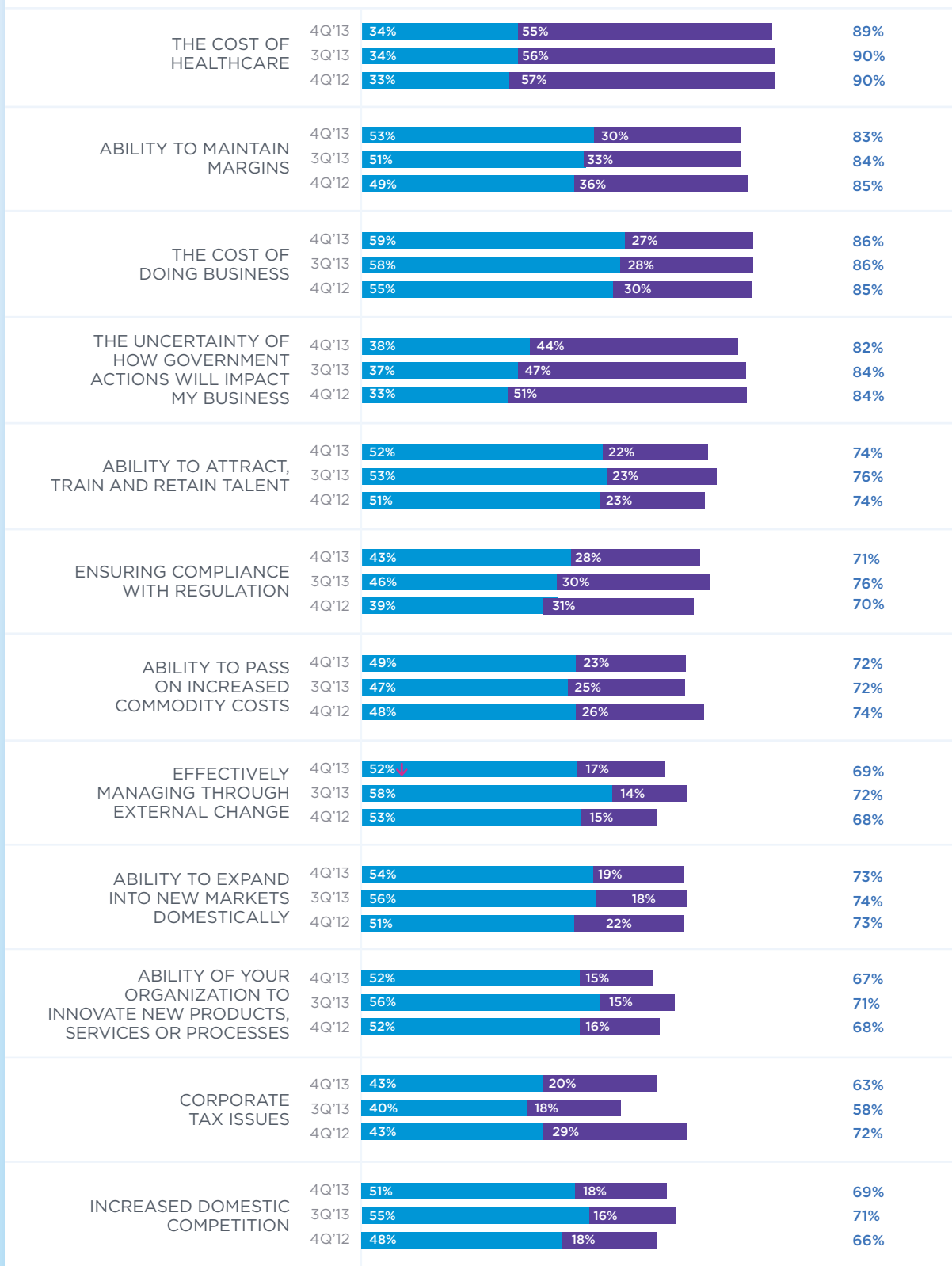
Meanwhile, executives said they are more likely to invest excess cash than hold it by a margin of almost 2-to-1. The percentage of those saying they are more likely to invest rose to 64%, matching the second quarter number, the highest level of the past five quarters.

“We’ll invest in technology before people...government is making it too costly to hire people. Healthcare cost uncertainty only adds to the problem.”

— CEO, Business Services, \$55MM annual revenue, 270 employees

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

MIDDLE MARKET CONTINUES TO DELIVER CONSISTENT, STEADY, AND STRONG PERFORMANCE

One of the notable attributes of the middle market is that it has continued to deliver consistently strong performance in both recessionary and growth periods for the overall economy. When the annualized revenue growth for S&P 500 firms was meager (e.g., only 0.9% and 1.0% in Q3 and Q4 2013, respectively), middle market firms in our survey report growing revenue at an impressive 5.0% rate over the past 12 months. Going forward, there are signs that the U.S. economy may continue to gain momentum. According to the Conference Board, U.S. GDP is forecasted to grow at 2.3% in 2014 after growing at 1.6% in 2013. The upper range for GDP growth according to Morning Star is 2.5%. This is relatively slow compared to China's growth rate of 7.0%, but represents a marked change for the U.S. economy which was stuck at 2% in 2011 and 2012. So, it may be surprising for some that middle market growth is predicated to slow over the next 12 months - 4.3% in our survey - in a faster growing economy. However, to put this in perspective, a couple of observations are worth highlighting. One, we have seen a consistent pattern of conservative forecasting by middle market managers in past surveys. Thus, the 4.3% growth rate prediction is likely understated. Two, even at the 4.3% growth rate, the middle market is expected to grow at a significantly higher rate than revenue growth rates predicted for large firms. Thus, the middle market has been the bedrock of the economy, delivering strong performance throughout this recovery.

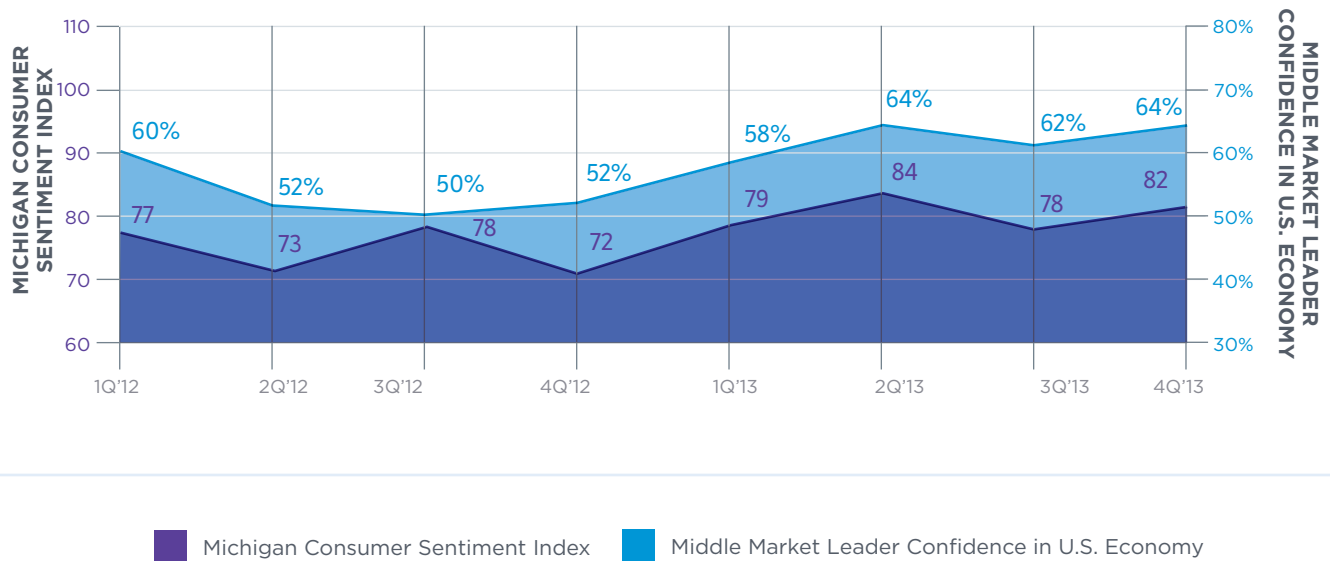
In terms of job creation, the middle market continues to show similarly remarkable performance. Employment grew at 2.5% in the previous 12 months and is expected to grow at a comparable rate in the next 12 months. The ability of the middle market to create jobs in good and bad times is particularly striking when we review its performance during the period 2007 to 2010. The National Center for the Middle Market has previously reported that during this period, which contains the Great Recession, middle market firms added 2.2 million jobs, even as large firms lost 3.7 million jobs over the same period.

GOVERNMENT IS ADVERSELY AFFECTING THE MIDDLE MARKET, LEADING TO STRONG DISAPPROVAL OF PRESIDENT OBAMA'S PERFORMANCE

To understand the extent of confidence middle market managers have in the U.S. economy, we regularly ask about the challenges they face. One of the challenges consistently raised is the uncertainty of government action and its impact. So, in the Q4 survey we also asked how it was impacting business: an overwhelming percentage of middle market managers (87%) report that uncertainty of government action is stifling growth. In particular, nearly two-thirds (63%) state that it has adversely affected hiring. Also, about two-thirds (63%) claim to have cut back on discretionary expenses (e.g., travel) to conserve resources in an uncertain environment. Some 56% of the respondents report that they are less likely to undertake capital outlays. With the fundamental ways in which uncertainty arising out of government actions is impacting business, it is not surprising that a large proportion of middle market managers (68%) disapprove of how President Obama is handling the U.S. economy.

Consumer vs. Business Sentiment

Consumer and business leader confidence runs in tandem.



INTRODUCING A NEW BAROMETER OF CONFIDENCE IN THE U. S. ECONOMY: MIDDLE MARKET EXECUTIVE SENTIMENT

With the eighth quarterly survey of the middle market, there are now growing data to start examining how well the middle market captures overall confidence in the U.S. economy. While 8 points are clearly not enough yet to statistically compare our MM Leader Confidence Index (percentage of middle market managers that are confident or somewhat confident in the U.S. economy) with other indexes, we can at least begin to graphically see how our index moves relative to other indexes, such as the Michigan Consumer Sentiment Index. The adjoining plot shows that the two indexes generally

move together, although our MM Leader Confidence Index shows smoother trends ("less jerky"). While the Michigan Consumer Sentiment views confidence from the consumer's perspective, our index is based on views from the producer's point of view. Arguably, their similarities and differences complement to provide a more holistic view of the economy. Apparently, consumer confidence has grown faster in recent days relative to the confidence exhibited by middle market managers.



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