

1Q 2014

MIDDLE MARKET INDICATOR



NATIONAL CENTER FOR
THE MIDDLE MARKET

In Collaboration With



THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS



GE Capital

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 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.

U.S. MIDDLE MARKET DEFINED

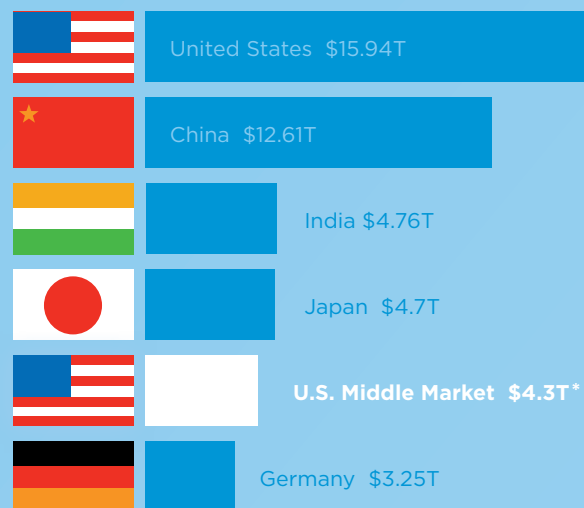
ANNUAL REVENUE
RANGING FROM

\$10MM – \$1B

NEARLY

**200,000
BUSINESSES**

**5TH
LARGEST**
GLOBAL ECONOMY



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

Executive Summary

The first quarter of 2014 marked a resurgence in growth for the U.S. middle market. The erosion in revenue and employment growth reported during the second half of 2013 reversed course, with companies reporting significant increases in both areas over the past 12 months. While year-over-year increases were experienced across all industry sectors, smaller middle market firms and firms in the wholesale trade industry have experienced some of the largest gains in revenue and hiring since last year. Revenue has been consistently projected to be slower than past growth; however, the future outlook for employment has improved significantly versus previous forecasts with nearly half of middle market firms anticipating an increase in the size of their workforces over the next year. These projections are in line with continued economic confidence, as well as decreasing concerns and uncertainty related to the impact of government regulations in areas such as healthcare.

For the first quarter of 2014, a majority (60%) of middle market firms reported improved overall company performance versus one year ago. The proportion of companies reporting improved performance has remained fairly stable over the past 12 months.

Middle market companies reported a year-over-year increase in revenue growth of 6.5% for the past 12 months, the largest rate of increase reported in the past four quarters. These results outpace the revenue growth for the S&P 500 as sales grew by 0.5% over the same period. The middle market continues to be a leading engine of growth.

In addition to revenue growth, the middle market added workers to the payroll. Thanks in part to greater transparency into the regulatory landscape, middle market companies appear to have a renewed confidence in their ability to hire, and nearly half (46%) of middle market firms employ a larger workforce than they did one year ago.

The same percentage of firms plan to add workers over the next 12 months. In fact, while employment growth has historically lagged behind revenue growth, projections indicate that the gap between the two metrics will shrink considerably over the course of the next year. With the relative increase in projected employment growth to 3.2% and the stabilization of projected revenue to 4.5%, productivity ratios are projected to decrease.

Significantly fewer companies report healthcare costs and government uncertainty as highly challenging issues this quarter, indicating that some key constraints to growth are diminishing. However, more middle market companies are shifting their focus to core business challenges related to increased growth and employment, such as their ability to access capital, manage higher salary expectations and deal with a potentially higher minimum wage.

With a current average tax rate of 19.6% for middle market firms, leaders in the middle market believe low corporate tax rates and greater simplicity are key components to a pro-growth tax code. In terms of participation in global markets, lack of demand and bureaucratic challenges continue to limit overseas expansion.

WITH INVESTMENTS TO DEVELOP OUR PEOPLE AS WELL AS BUILD THE BEST E-COMMERCE EXPERIENCE FOR CUSTOMERS, WE HAVE SET OURSELVES UP TO ACCELERATE MARKET SHARE GROWTH.

**CFO, WHOLESALE INDUSTRY,
\$44M ANNUAL REVENUE,
84 EMPLOYEES**

Looking forward to the next 12 months, middle market companies anticipate revenue growth of 4.5%, which is higher than the projected growth rates in the previous two quarters. The likelihood of expansion over the next 12 months is also higher than it was during the middle of 2013. More than half (57%) of firms with revenues between \$50-100MM expect to introduce a new product or service in the next year, up from 39% at the end of 2013.



REVENUE GROWTH

Growth is strong, but predicted to slow

For the past 12 months, 64% of middle market companies reported an increase in gross revenues compared to one year ago. Revenue grew by 6.5% over the past 12 months, the largest year-over-year revenue increase reported in the past four quarters and reversing a year-long slide in reported growth rates. The wholesale trade industry experienced the largest increase in year-over-year revenue change, reporting 8.4% revenue growth for the past 12 months versus the 2.6% reported in the fourth quarter of last year. Retail firms also experienced a rebound.

Middle market leaders remain positive about future revenue growth and about 59% expect gross revenue to increase. Compared to growth projections of 4.3% last quarter, middle market firms are forecasting slightly better year-ahead revenue growth at 4.5%.

1Q'14
64%

of middle market companies reported positive revenue growth

1Q'13
63%

MIDDLE MARKET

PAST 12 MO.

1Q'14

6.5%

4Q'13 5.0% 1Q'13 5.8%

NEXT 12 MO.

1Q'14

4.5%

4Q'13 4.3% 1Q'13 4.9%

S&P 500

PAST 12 MO.

1Q'14

0.5%

4Q'13 3.9% 1Q'13 5.6%

NEXT 12 MO.

1Q'14

2.2%

4Q'13 1.9% 1Q'13 N/A



EMPLOYMENT GROWTH

Hiring trends expected to continue

In the first quarter of 2014, 46% of middle market companies reported a larger workforce than one year ago, a significant increase over the 39% of companies that said their workforce was larger in the fourth quarter of 2013. Additionally, companies reported a significantly larger percentage (3.7%) of employment growth over the past year than had been reported in the previous four quarters. The wholesale trade industry reported a 4.8% larger workforce while employment growth remained stable across other industries.

Perhaps more significantly, the future outlook for employment is just as positive, with 46% of middle market firms saying they expect to increase the size of their workforce over the next 12 months. Mean employment growth has also increased significantly to 3.2%.

1Q'14
46%

of middle market companies expect to add jobs.

1Q'13
38%

MIDDLE MARKET

PAST 12 MO.

1Q'14

3.7%

4Q'13 2.5% 1Q'13 2.2%

NEXT 12 MO.

1Q'14

3.2%

4Q'13 2.2% 1Q'13 2.1%

ADP [PAST 12 MO.]

LARGE CORP.

1Q'14

2.6%

4Q'13 2.3% 1Q'13 2.3%

SMALL BUS.

1Q'14

2.1%

4Q'13 2.0% 1Q'13 1.5%



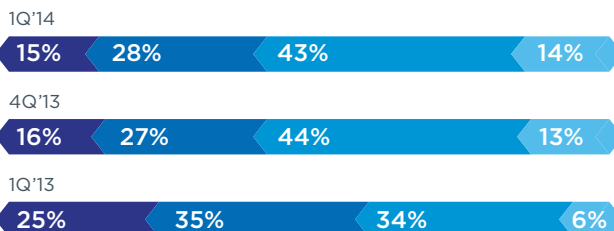
ECONOMIC CONFIDENCE

Confidence remains high

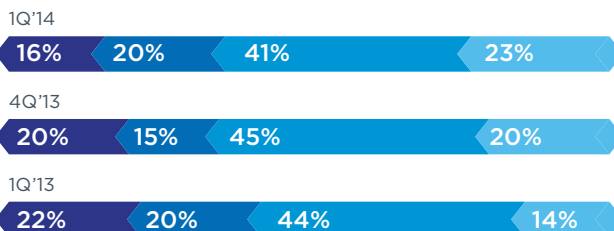
Continuing the trend from last quarter, 57% of middle market leaders remain at least somewhat confident in the global economy, up from 40% one year ago. Specifically, confidence in the global economy is increasing among middle market leaders in the services sector, with 20% expressing confidence versus just 12% three months ago. Conversely, construction industry leaders have an

increasingly pessimistic view, with just 34% expecting the global economy to grow. Confidence in the U.S. economy has remained stable over the past 12 months with nearly two-thirds of middle market leaders feeling at least somewhat confident in national prospects. Of middle market executives, 81% are at least somewhat confident in their local economy, with only 9% lacking any confidence at all.

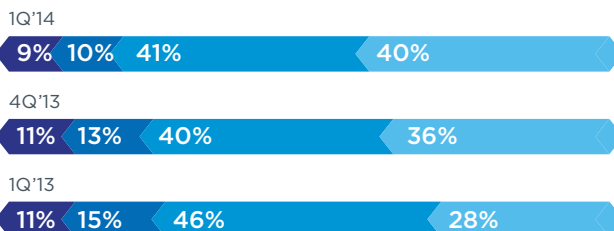
GLOBAL ECONOMY



NATIONAL ECONOMY



LOCAL ECONOMY





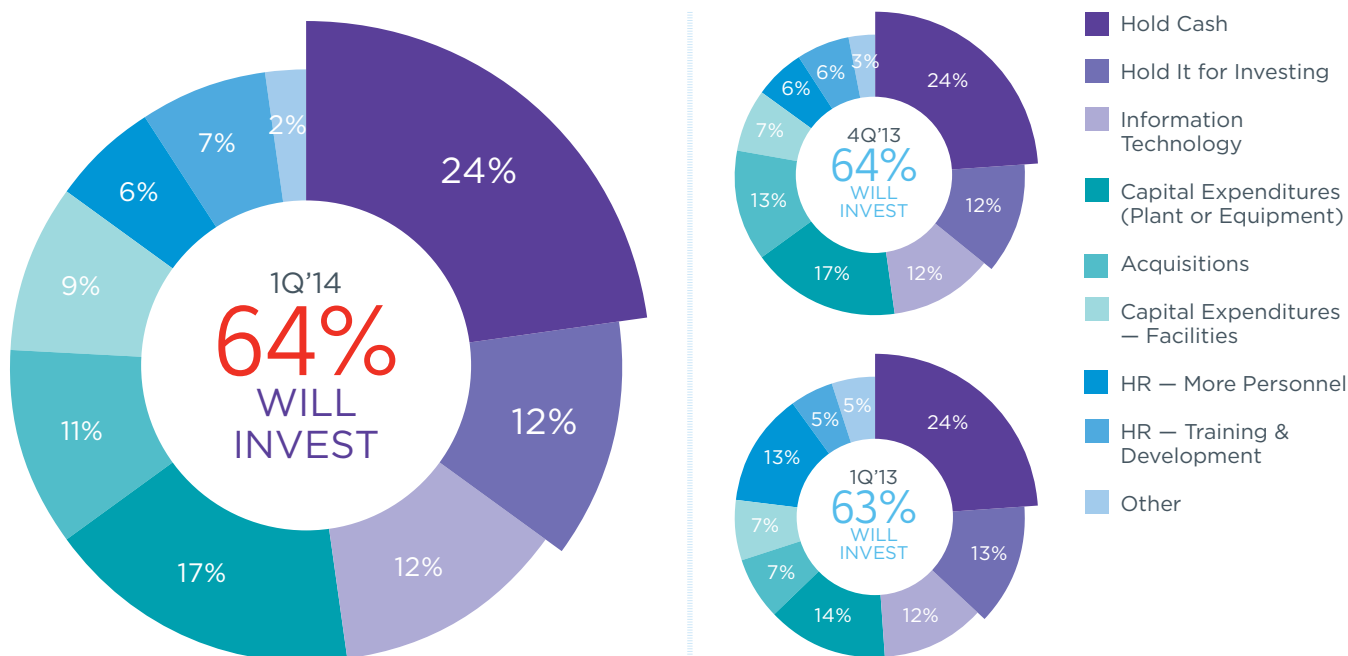
CAPITAL INVESTMENT

Plans for capital investment remain stable

Plans among middle market companies for investing capital have not changed since the past quarter—64% of middle market companies plan to invest while 36% plan to hold on to cash or invest in short term financial instruments. These percentages are virtually the same as one year ago, when 63% planned to invest and 37% planned to save.

In addition, the percentage of large middle market firms planning to invest in capital expenditures, such as plant and equipment, increased significantly to 22% in the first quarter of 2014 from 13% last quarter and 10% a year ago. Saving and spending patterns for middle market firms in each industry have been relatively stable over the past year.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Business challenges supplant regulatory concerns

The cost of healthcare remains the dominant challenge for middle market firms, but the intensity of this challenge is moderating. The number of companies considering healthcare costs to be “highly challenging” decreased to 46% this quarter from 55% at the end of 2013. Uncertainty about government actions is also moderating with 34% of middle market firms considering it to be highly challenging this quarter compared to 44% last quarter. As concerns over government regulations diminish, more firms list issues like ability to access capital or financing and labor difficulties as highly/somewhat challenging. Cost and wage pressures appear to be replacing government regulations as the most forceful headwinds.

TOP CHALLENGES

- | | |
|--|-----|
| 1. THE COST OF HEALTHCARE | 86% |
| 2. ABILITY TO GROW REVENUE | 83% |
| 3. THE COST OF DOING BUSINESS | 83% |
| 4. ABILITY TO MAINTAIN MARGINS | 81% |
| 5. THE UNCERTAINTY OF HOW GOVERNMENT ACTIONS WILL IMPACT MY BUSINESS | 76% |

Perspectives

WITH GOVERNMENT-RELATED CHALLENGES ABATING, THE MIDDLE MARKET EXPERIENCES STRONG GROWTH

During spring 2013, the macroeconomic environment was chaotic in the aftermath of tax increases from the fiscal cliff, spending cuts related to sequestration and government budgets, fears of capital problems arising out of the political gridlock over the debt ceiling, and concerns over runaway costs due to the Affordable Care Act. Today, many of those challenges have apparently eased, or at least do not appear as urgent in the minds of middle market executives. One year ago, 45% of survey respondents noted uncertainty of government action as highly challenging. Now, in Q1 2014, that percentage is down to 34%. Similarly, only 46% of respondents in this current survey consider healthcare costs a highly challenging issue as opposed to 57% a year ago. As these environmental pressures have eased, revenue growth in the past 12 months has rebounded to an impressive 6.5%. Furthermore, the projected rate of revenue growth stands at a robust 4.5% for the upcoming 12 months. Similarly, employment growth rates are higher than they have been for several quarters, having grown at 3.7% in the past 12 months and projected to grow at 3.2% in the next 12 months. Confidence in their local and regional economy, which matters most to middle market leaders, is at an all-time high in our nine quarterly surveys, with an overwhelming 81% of the respondents expressing some level of confidence. Performance and optimism are reflective of positive changes over the past year.

BACK TO BUSINESS

Instead of stressing over macroeconomic challenges, middle market firms are turning their attention to business issues. A higher percentage of respondents, relative to a year ago, consider labor difficulties, access to talent and maintaining a sharp customer focus as highly challenging. Consistent with such challenges, nearly half of the executives surveyed (48%) report that new hires are expecting higher wages than a year ago. These business challenges potentially constrain middle market firms from more expansive investment activity. The percentage of respondents who claim that they would invest an extra dollar, instead of hoarding it as cash or in short-term financial instruments, remains unchanged at 64%. Incidentally, access to capital does not rise to the top of the current challenges faced by middle market firms, perhaps because many firms are sitting on excessive cash or because capital is readily available at interest rates that remain low.

IN A REBOUNDED U.S. ECONOMY, THE MIDDLE MARKET REMAINS THE ENGINE OF GROWTH

Both over the past 12 months and in expectations for the next 12 months, middle market firms continue to hold their lead in performance compared to other segments. While middle market firms grew at 6.5%, S&P 500 firms grew at 0.5% during the past 12 months. Employment growth of 3.7% for middle market firms in the past year exceeded the growth rates of the large (2.6%) and small (2.1%) firm segments based on ADP data. Looking ahead, middle market firms say they expect to grow revenue two times faster than the S&P 500 firms, 4.5% versus 2.2%. The middle market continues to be the economic engine driving the U. S. recovery, but its full potential may still be constrained based on shifting headwinds and management's ongoing conservatism.



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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