



NATIONAL CENTER FOR
THE MIDDLE MARKET

1Q 2016

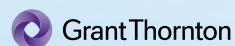
MIDDLE MARKET INDICATOR

GROWTH STABILIZES; OUTLOOK IMPROVES

IN COLLABORATION WITH



THE OHIO STATE UNIVERSITY
FISHER COLLEGE OF BUSINESS



Middle Market Indicator

from the National Center for the Middle Market

THE MIDDLE MARKET INDICATOR (MMI) FROM THE NATIONAL CENTER FOR THE MIDDLE MARKET IS A QUARTERLY BUSINESS PERFORMANCE UPDATE AND ECONOMIC OUTLOOK SURVEY CONDUCTED AMONG 1,000 C-SUITE EXECUTIVES OF COMPANIES WITH ANNUAL REVENUES BETWEEN \$10MM AND \$1B.

There are nearly 200,000 U.S. middle market businesses that represent one-third of private sector GDP, employing approximately 47.9 million people. These businesses outperformed through the financial crisis (2007-2010 period) by adding 2.2 million jobs across major industry sectors and U.S. geographies, demonstrating their importance to the overall health of the U.S. economy. They are private and public, family owned, and sole proprietorships, geographically diverse, and span almost all industries. The health of these businesses and their respective outlook serve as a solid indicator for the greater U.S. economy as a whole. (See www.middlemarketcenter.org: "The Market that Moves America," seminal research on the definition, significance, and role of the middle market, Oct. 2011.)

HOW IS THE RESEARCH CONDUCTED?

The MMI surveys 1,000 CEOs, CFOs, and other C-suite executives of America's middle market companies on key indicators of past and future performance in revenues, employment, and allocation of cash. The survey also reports middle market company confidence in the global, U.S., and local economies and identifies key business challenge areas. The survey was designed to accurately reflect the nearly 200,000 U.S. businesses with revenues between \$10MM and \$1B, the lower and upper limits on middle market annual revenue. The quarterly survey is designed and managed by the National Center for the Middle Market.

ABOUT THE NATIONAL CENTER FOR THE MIDDLE MARKET

The National Center for the Middle Market is a collaboration between The Ohio State University's Fisher College of Business, SunTrust Banks Inc., Grant Thornton, and Cisco Systems. It exists for a single purpose: to ensure that the vitality and robustness of middle market companies are fully realized as fundamental to our nation's economic outlook and prosperity. The Center is the leading source of knowledge, leadership, and innovative research on the middle market economy, providing critical data analysis, insights, and perspectives for companies, policymakers, and other key stakeholders, to help accelerate growth, increase competitiveness and create jobs in this sector. To learn more visit: www.middlemarketcenter.org.

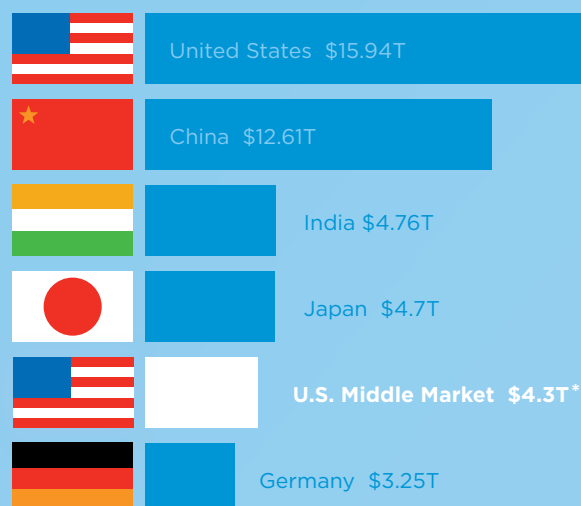
U.S. MIDDLE MARKET DEFINED

ANNUAL REVENUE
RANGING FROM
\$10MM - \$1B



NEARLY
200,000
BUSINESSES

5TH
LARGEST
GLOBAL ECONOMY



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

Executive Summary

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

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

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

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

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

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

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

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



REVENUE GROWTH

Growth stabilizes at a healthy rate

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

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

1Q'16
69%

of middle market
companies reported
positive revenue growth.

1Q'15
70%

MIDDLE MARKET

PAST 12 MO.

1Q'16

6.3%

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

NEXT 12 MO.

1Q'16

4.6%

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

S&P 500

PAST 12 MO.

1Q'16

-3.4%*

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



EMPLOYMENT GROWTH

Employment growth rates remain consistent

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

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

1Q'16
34%

of middle market
companies
expect to add jobs.

1Q'15
39%

MIDDLE MARKET

PAST 12 MO.

1Q'16

3.6%

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

NEXT 12 MO.

1Q'16

2.7%

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

ADP [PAST 12 MO.]

LARGE CORP.

1Q'16

2.2%

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

SMALL BUS.

1Q'16

2.1%

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



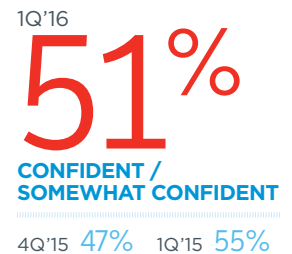
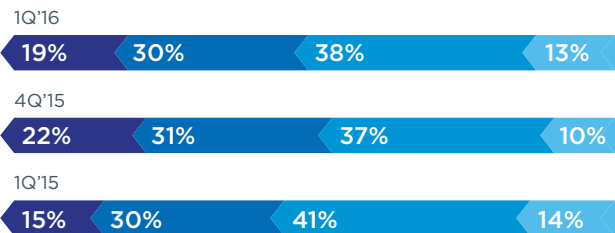
ECONOMIC CONFIDENCE

Confidence rebounds across the board

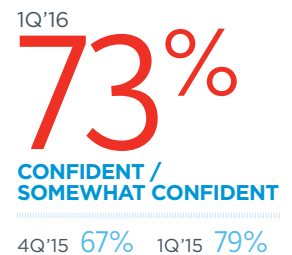
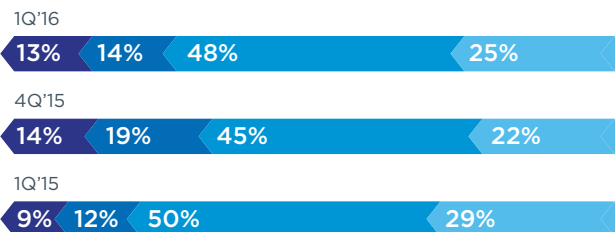
Middle market leaders' confidence in the global, national, and local economies cooled slightly at the end of last year. For Q1 2016, confidence returned to the higher levels seen in mid 2015. A majority of companies are confident in the global state of affairs, while almost three-quarters have a positive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

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

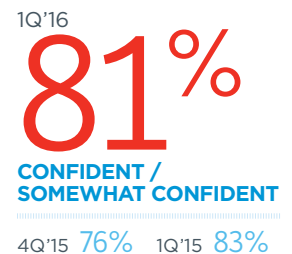
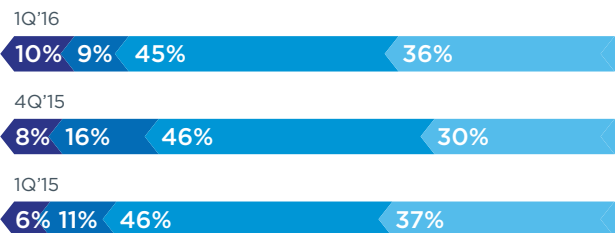
GLOBAL ECONOMY



NATIONAL ECONOMY



LOCAL ECONOMY





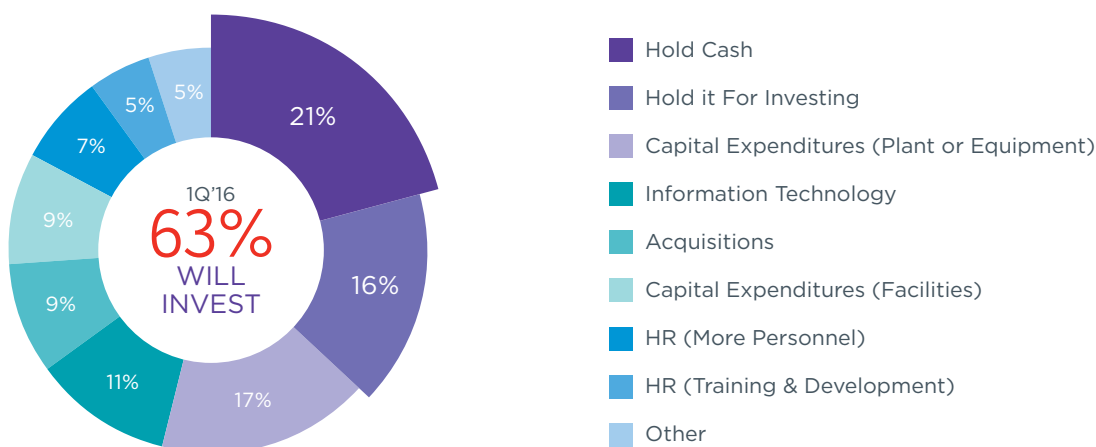
CAPITAL INVESTMENT

Most firms will invest

The proportion of middle market firms willing to invest extra cash as opposed to hold it has remained relatively consistent over the past three years. Quarter after quarter, around two-thirds of firms say they would invest extra dollars. That number rose to 68% at the end of 2014, then fell gradually throughout 2015. It appears stable at 63% today. Plans for expansion,

however, remain relatively muted with about a third of firms planning to introduce a new product or service or expand into new domestic markets over the next 12 months. Core middle market companies are the exception: A slight majority of these companies say they plan to debut a new product or service this year.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Staffing concerns, compliance, and competition continue to challenge firms

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

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

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS 62%
2. STAFF/EMPLOYEES 51%
3. COSTS 22%
4. GOVERNMENT 9%

EXTERNAL CHALLENGES:

1. BUSINESS 34%
2. GOVERNMENT 21%
3. COMPETITION 20%
4. ECONOMY 16%
5. COSTS 14%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. STAFF/EMPLOYEES 40%
2. BUSINESS 40%
3. COSTS 15%
4. GOVERNMENT 4%

EXTERNAL CHALLENGES:

1. BUSINESS 26%
2. GOVERNMENT 20%
3. COMPETITION 14%
4. ECONOMY 14%
5. COSTS 13%

Perspectives

A RETURN TO OPTIMISM

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

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

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

STILL CAUTIOUS AFTER ALL THESE YEARS

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

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

RAISES RISING?

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



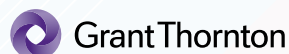
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