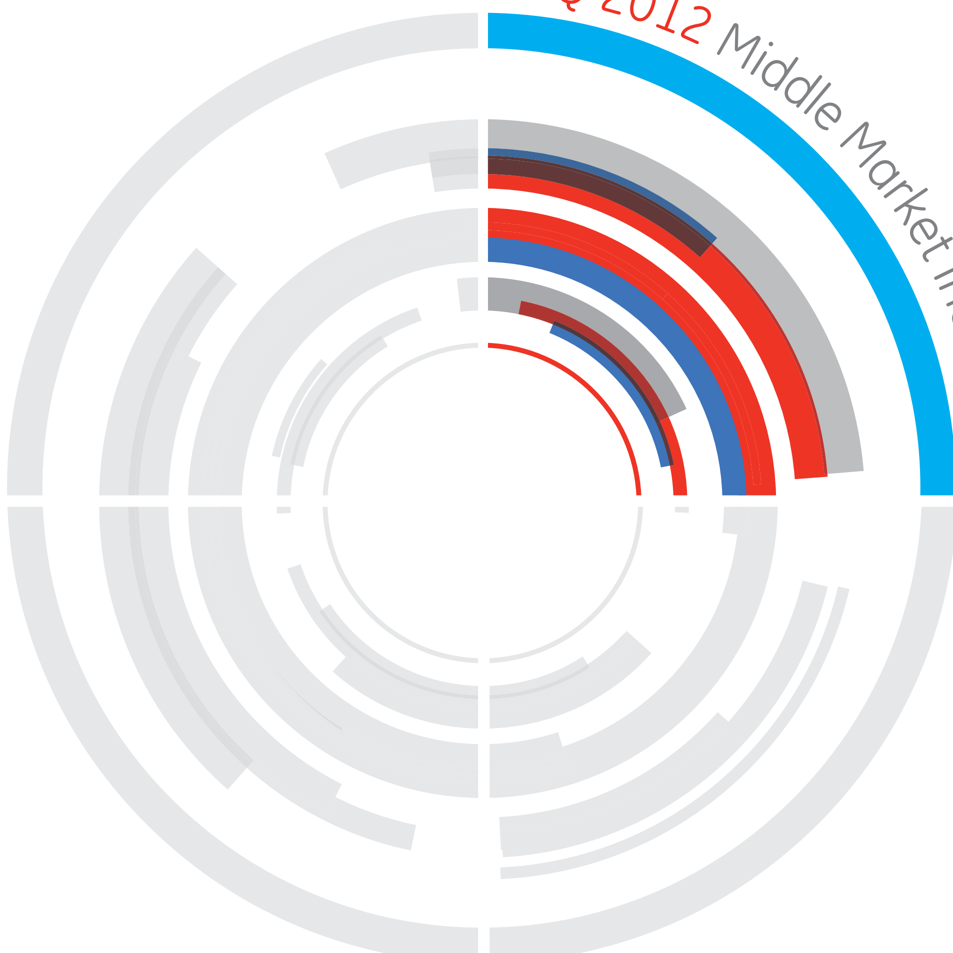
NATIONAL CENTER FOR THE MIDDLE MARKET

2Q 2012 Middle Market Indicator



in collaboration with

THE OHIO STATE UNIVERSITY FISHER COLLEGE OF BUSINESS

GE Capital

contents

Middle Market Indicator

from The National Center for the Middle Market

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

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

There are approximately 195,000 U.S. middle market businesses that represent one-third of private sector GDP, employing approximately 41 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 195,000 U.S. businesses with revenues between $10MM and $1B, the upper and lower limits on middle market annual revenue.

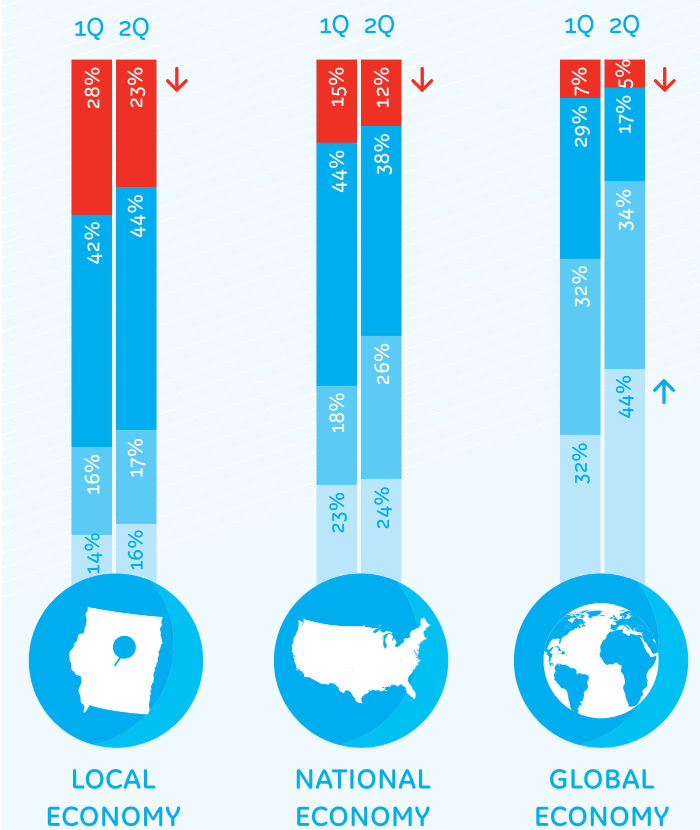
The quarterly survey is designed and managed by The National Center for the Middle Market.

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**.

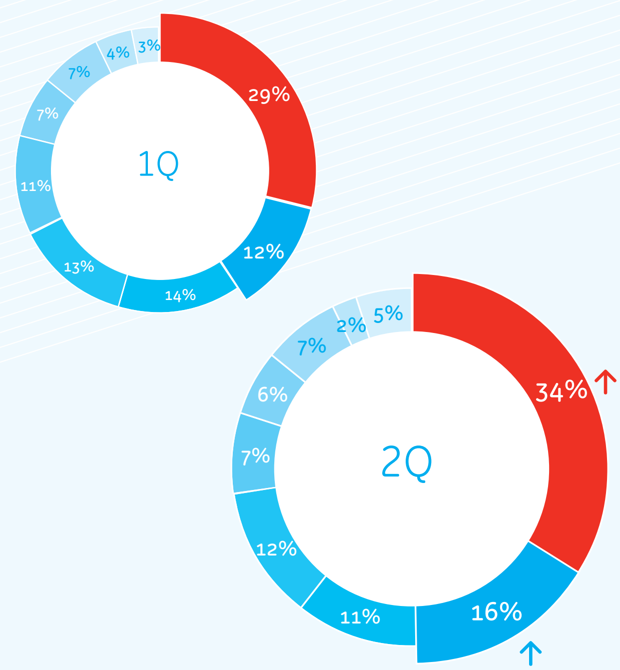
MIDDLE MARKET
INDICATOR
$10MM–$1B

Economic confidence indicators



- Confident
- Somewhat confident
- Somewhat not confident
- Not confident

Incremental investment allocation



- Hold cash
- Hold it for investing
- Information technology
- Capital expenditures—plant or equipment
- Acquisitions
- Capital expenditures—facilities
- HR—more personnel
- HR—training & development
- Other

Growth indicators

REVENUE GROWTH	1Q	2Q
MIDDLE MARKET		
PAST 12 MO.	6.9%*	6.1% ↓
NEXT 12 MO.	5.2%*	4.8% ↓
S&P 500		
PAST 12 MO.	9.4%	4.8% ↓
NEXT 12 MO.	4.7%	4.0% ↓

EMPLOYMENT GROWTH	1Q	2Q
MIDDLE MARKET		
PAST 12 MO.	1.5%*	2.0% ↑
NEXT 12 MO.	N/A	1.8%
S&P 500 (PAST 12 MO.)		
LARGE CORP.	1.7%	1.0% ↓
SMALL BUS.	1.9%	1.0% ↓

*Revised. See appendix (p. 15).

executive summary

Middle market companies express increased pessimism about global and U.S. prospects and a rising propensity to hold cash due to headwinds. Companies are holding more cash, and feel most challenged by the cost of health care, the uncertainty around government actions, and the impact these factors will have on their business. The latest revenue performance and projection figures indicate a slowing of revenue growth into next year for most industries. Middle market companies are hiring and intend to grow net jobs. In fact, 90% of businesses expect either no change or increases in hiring over the next 12 months. Stronger jobs growth is expected for the services sector, construction, and health care, with a contraction in payroll expected in retail. Middle market companies are hiring at two times the rate of both large corporations and small businesses.[1]

Key findings:

The middle market continues to lose confidence in the global and U.S. economies
Only 5% of survey respondents expressed confidence in the global economy, compared with 44% saying they were not confident at all. Those numbers are slightly better for the U.S. economy, with 12% responding that they were confident compared with 24% not at all. The waning confidence in the global and U.S. economies from the first quarter to second spans every major industry segment measured.

Future investment to remain limited; businesses continue to hold cash in the face of uncertainty
In the second quarter, 50% of middle market companies said they planned to hold any extra dollars instead of investing them, up from 41% in the first quarter.

Revenue growth seen but slowing
Year-over-year (YOY) revenue performance from 1Q to 2Q has slowed from 6.9% to 6.1% and projected revenue growth for the next 12 months is down from 5.2% to 4.8% quarter over quarter. Middle market companies expecting revenues to increase 10% or more in the next 12 months dropped to 23%, compared with 28% who expected double-digit growth in the previous quarter's survey. Of note is that middle market businesses expect higher rates of revenue growth in the next 12 months (4.8%) than the S&P revenue projections (3.4%).[2]

Employment growth is stable and projected to hold into next year
Net YOY jobs growth increased from 1.5% in 1Q to 2.0% in 2Q and the expectations for the next 12 months are stable at 1.8%. Middle market payroll growth rate for 2Q is two times the level reported for both large corporations (1%) and small businesses (1%). Nearly 90% of middle market companies anticipate stable or increased hiring in the next 12 months, with only 11% reporting they expect to shrink payrolls. Services, construction, and health care expect to be most aggressive at hiring, with retail businesses expecting a contraction in their payrolls.

Challenges to middle market business performance persist
A large majority of middle market companies cited uncertainty about health care costs and new government actions as either very or somewhat challenging in the second quarter. These challenges persist from last quarter as the most vexing issues—not surprising since there was little clarity from the U.S. government around changes to health care and other laws at the time of the survey.

1 ADP Jobs Report (large companies 500+ employees, small companies <50 employees; July '11–June'12)
2 S&P Index Services (June '11–July '12)

detailed research findings:

recent and expected growth

PAST 12 MO. REVENUE	1Q	2Q	
BY REVENUE SEGMENT			
$10MM–<$50MM	6.0%	5.8%	=
$50MM–<$100MM	6.5%	5.3%	↓
$100MM–$1B	8.3%	7.0%	↓

NEXT 12 MO. REVENUE	1Q	2Q	
BY REVENUE SEGMENT			
$10MM–<$50MM	5.4%	4.4%	↓
$50MM–<$100MM	4.8%	4.4%	↓
$100MM–$1B	5.0%	5.5%	↑

Moderation in revenue growth

Revenue growth has slowed in the past 12 months compared with growth in the first quarter, dropping annualized rates from 6.9% to 6.1%. During 2Q, there has been an increase in the proportion of companies reporting flat YOY growth from 14% to 22% and a corresponding decrease in companies reporting double-digit revenue growth performance—from 38% to 32%. Looking at the data by industry shows mixed results, with business services, financial services, and construction leading year-over-year gains. Manufacturing, wholesale trade, retail, and health care all posted declines in revenue during the second quarter.

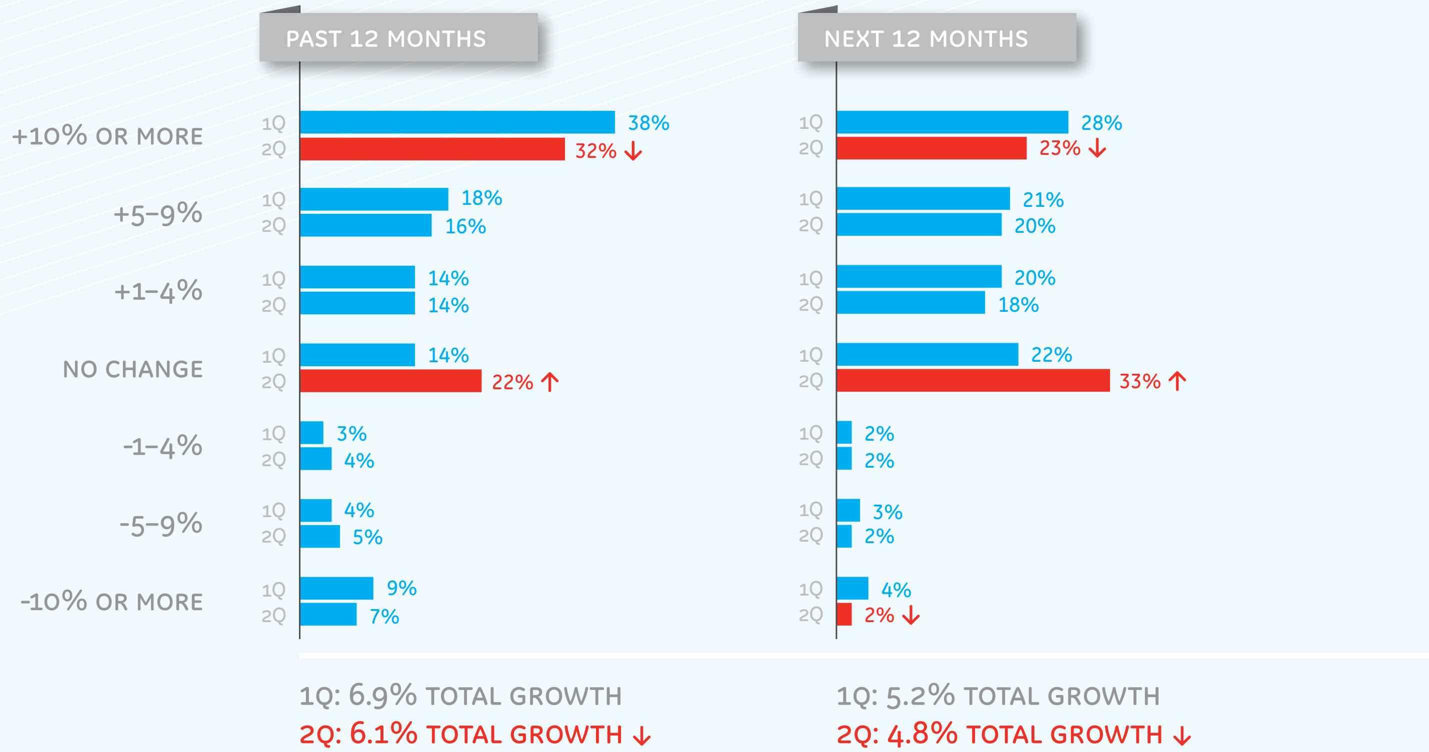
In the next 12 months, revenue growth is also expected to moderate—from 5.2% to 4.8%. The percentage of middle market companies expecting revenues to increase 10% or more in the next 12 months dropped to 23% of the middle market compared with 28% in the previous quarter's survey, and one-third of businesses expect flat YOY growth, compared with 22% in 1Q.

Overall, revenue projections are down among a wide range of companies with revenues spanning $10MM–$100MM. This revenue distribution accounts for 95% of all middle market companies.[3]

3 U.S. Census

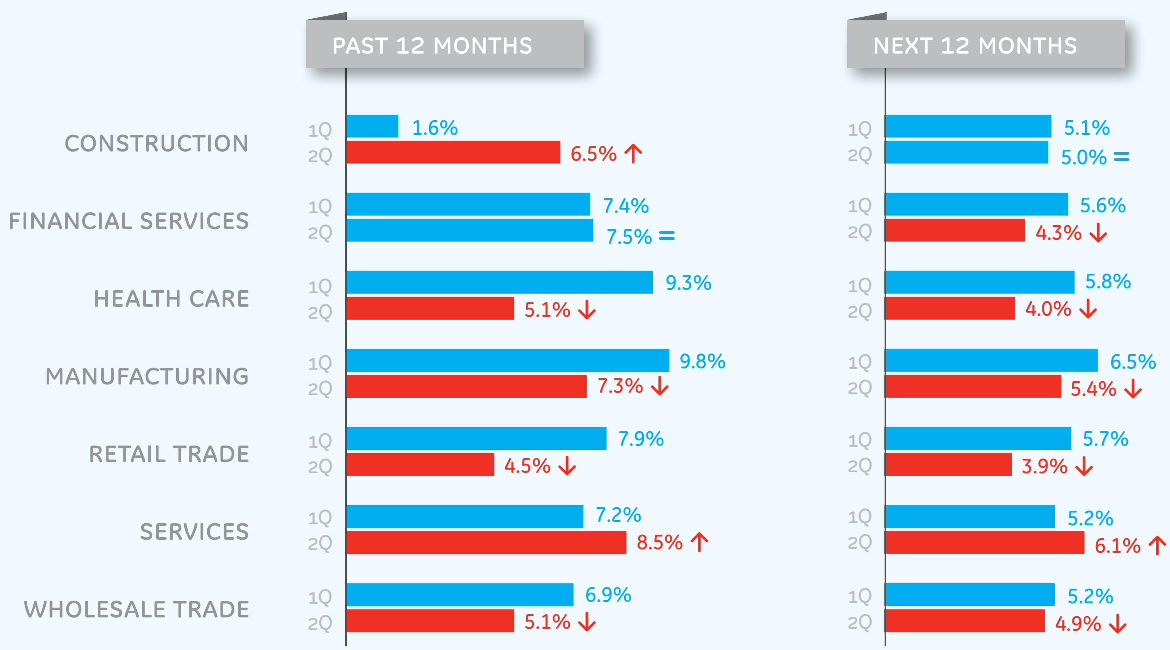
Revenue performance

The proportion of companies indicating growth in YOY revenues is lower in the second quarter (particularly those indicating strong growth). While overall anticipated growth is stable, fewer companies expect to grow 10% or more.



Revenue performance by industry

Overall YOY revenue growth is most evident in construction, but the proportion indicating positive YOY revenue is down significantly in four industry sectors. Revenue growth is expected across the categories, but the proportion of health care and wholesale trade companies expecting growth has declined since first quarter.



Q1. (Past 12 months) What is the percentage of change in your company's current gross revenues compared to the same time period a year ago? Please record a number to the nearest whole percentage.

Q11a. (Next 12 months) How would you assess the future outlook for your company?

detailed research findings:
recent and expected growth

PAST 12 MO. EMPLOYMENT	1Q	2Q
BY REVENUE SEGMENT		
$10MM–<$50MM	1.2%	1.7% ↑
$50MM–<$100MM	0.7%	2.5% ↑
$100MM–$1B	2.3%	2.2% ↓

NEXT 12 MO. EMPLOYMENT	1Q	2Q
BY REVENUE SEGMENT		
$10MM–<$50MM	N/A	1.8%
$50MM–<$100MM	N/A	1.5%
$100MM–$1B	N/A	1.8%

Employment growth is stable and projected to hold

Net jobs growth YOY increased from 1.5% in 1Q to 2.0% in 2Q, and the expectation for next 12 months is stable at 1.8%.

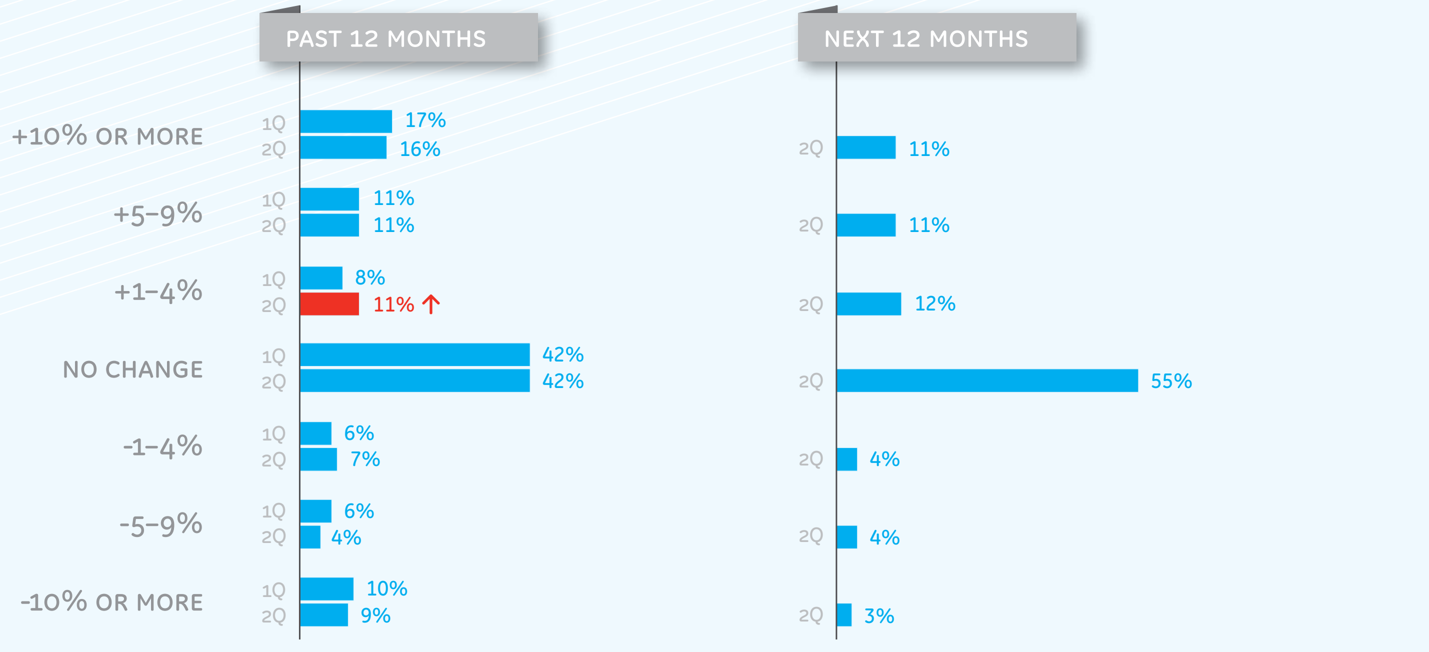
YOY employment contribution increased across all three middle market revenue segments. Business services, construction, and financial services posted the biggest employment growth rate gains compared to those reported in the first quarter. Hiring was slower for health care, retail trade, and manufacturing sectors.

Going forward, one in three middle market businesses expect to contribute positive net job growth in the next 12 months. This translates to net positive payroll growth of 1.8%, consistent with previously reported levels. Expected employment growth will vary by industry with services, health care, and construction expecting the highest hiring rates in the coming year with expansions of 3.5%, 2.2%, and 2.9%, respectively. Retail trade is the only sector to expect a contraction in payroll of -0.1%.

In terms of geography, the middle market projects above-average job creation in the Midwest and the South, both at 2.0%. The Northeast is expected to only add 1.3% in employment and the West plans to add jobs at 1.6%.

Employment performance

Despite headwinds, the middle market continues to add jobs at the same rate as first quarter. By a margin of two to one, more companies anticipate adding jobs than contracting. On average, the middle market workforce is expected to grow 1.8%.

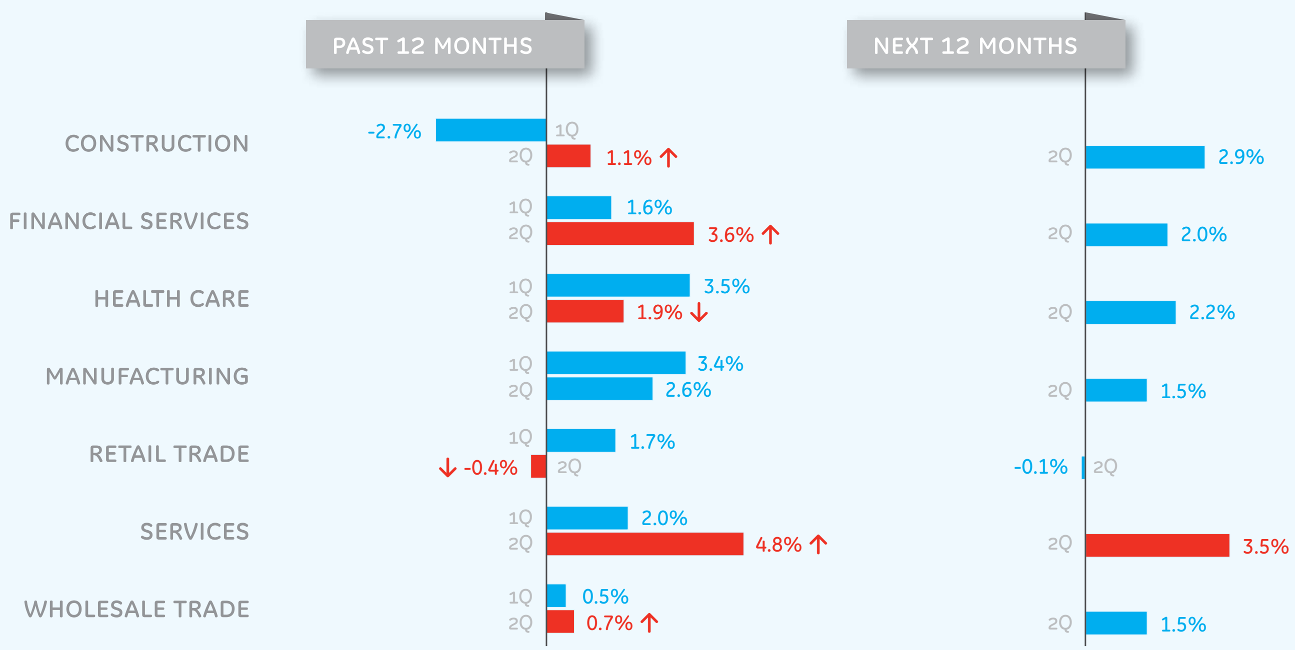


1Q: 1.5% TOTAL GROWTH
2Q: 2.0% TOTAL GROWTH

1Q: N/A
2Q: 1.8% TOTAL GROWTH

Employment performance by industry

Employment growth expectations are stronger among services, health care, and construction businesses.



Q11a1. During the next 12 months, do you anticipate that the size of your company's workforce will...?
Q11a2. How many employees do you expect to hire in the next 12 months as a percentage of your total workforce?
Q11a3. How many employees do you expect to let go in the next 12 months as a percentage of your total workforce?

detailed research findings:
confidence and economic growth outlook

Increased pessimism in the global outlook

Middle market companies are uniformly and increasingly pessimistic about the global economic outlook, with only 5% expressing a high degree of confidence in future prospects, down from 7% reported last quarter. Meanwhile, 44% of companies have no confidence in the global outlook.

Sentiments remain bleak closer to home, as 12% of respondents expressed confidence in the U.S. economy, a drop from 15% in the previous quarter. Companies feel somewhat better about their local economies, with 23% expressing confidence.

Broad sectoral deterioration in U.S. confidence

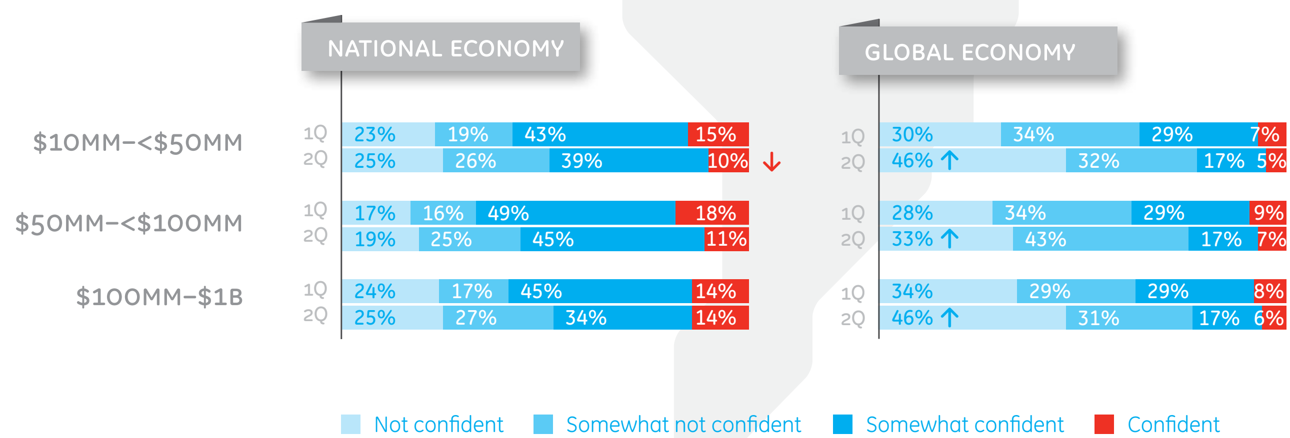
Confidence in the U.S. economy by managers in manufacturing, financial services, and wholesale trade has eroded the most. This would make sense given that the latest June Institute of Supply Management Index levels fell from 53.5 (May) to 49.7, the lowest level since July, 2009.[4]

Middle market companies are predicting the economy to slow down across the board from local to global levels. This is true across revenue segments and for those expecting growth, as well as those anticipating revenue decline.

4 ISM Manufacturing Index

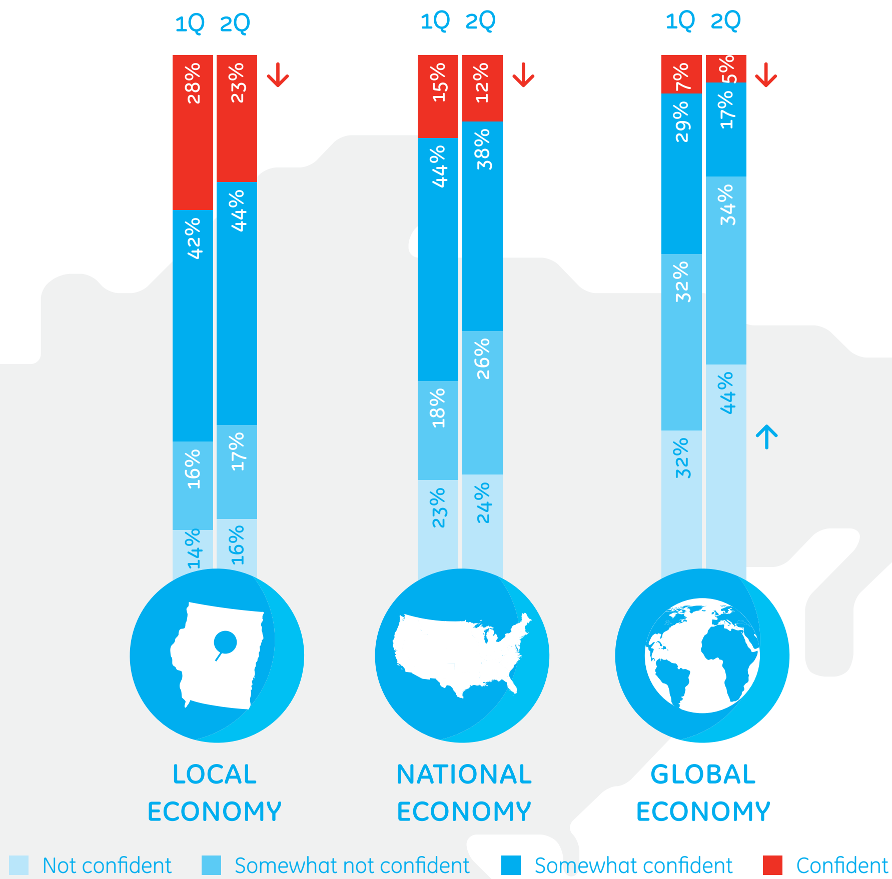
Confidence by revenue segment

Confidence in the global economy is down across the board.



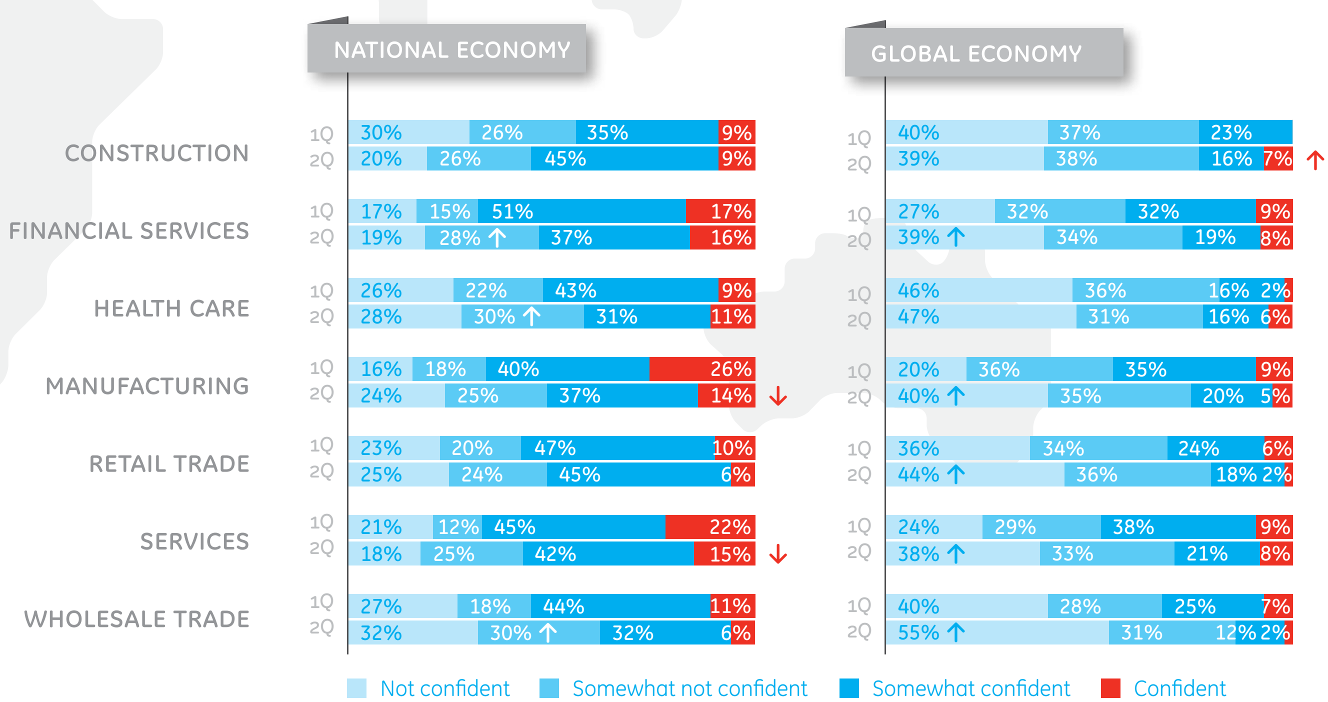
Confidence

Confidence in both the global and national economies is dramatically lower than in the first quarter.



Confidence by industry

Most notable is the decline of confidence in the U.S. economy by the manufacturing sector, which had been a bright spot in the recovery to date.

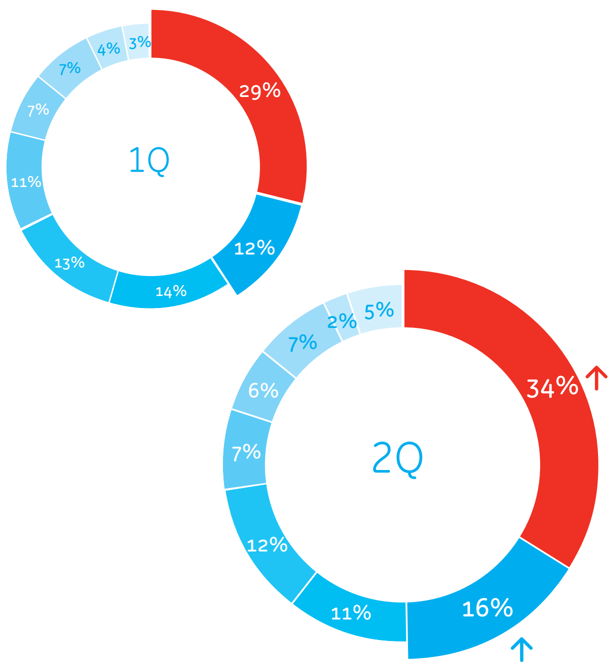


Q7. How confident are you in each of the following (industries)?

detailed research findings:

confidence and economic growth outlook

Incremental investment allocation



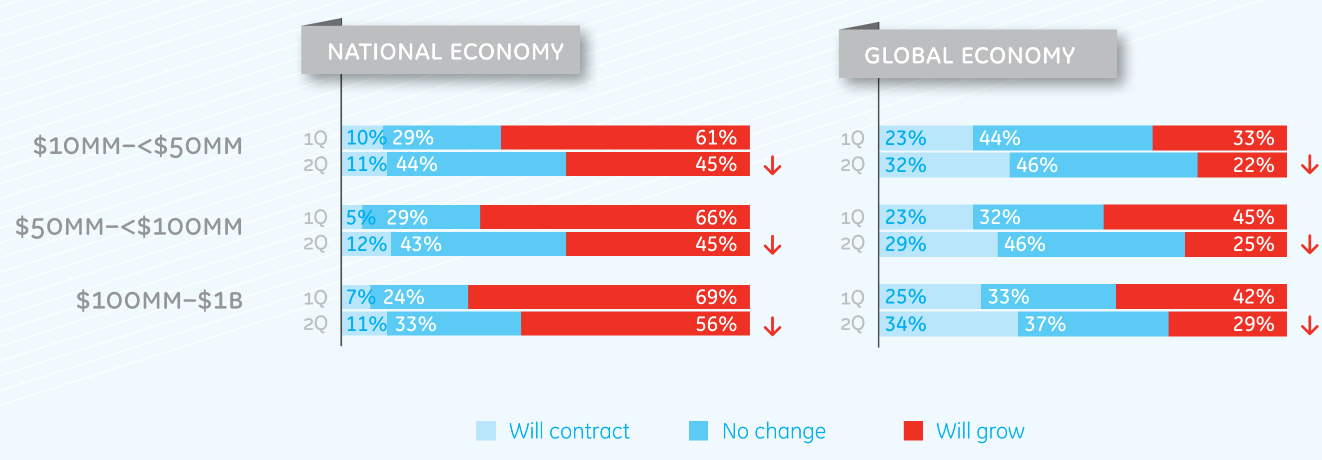
- Hold cash
- Hold it for investing
- Information technology
- Capital expenditures—plant or equipment
- Acquisitions
- Capital expenditures—facilities
- HR—more personnel
- HR—training & development
- Other

Higher tendency to hold cash

The percentage of businesses that plan to hold cash rather than invest in either IT, HR/talent, capital expenditures, or acquisitions has grown dramatically, from 41% in 1Q to 50% in 2Q. Of those, manufacturers showed the greatest increase in saving. In the first quarter, they were the most likely to spend. Their willingness to invest in capital expenditures dropped as well, signaling a retraction in this sector, which is a large part of the midwestern U.S. economy.

Economic growth outlook by revenue segment

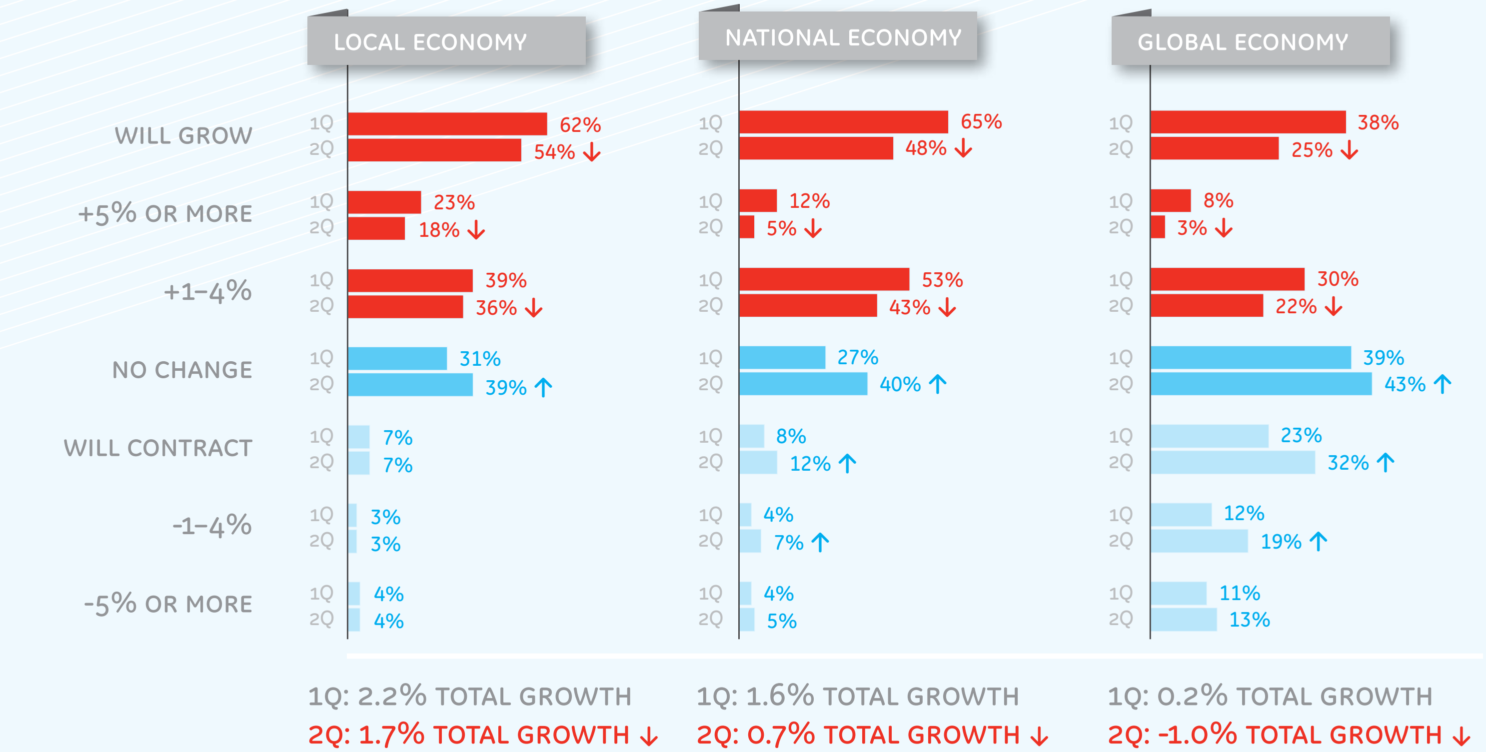
Pessimism is evident across revenue segments.



Q12a. If you had an extra $1 of investment, where would you allocate it?
Q8. How would you assess the future outlook of the global economy?
Q9. How would you assess the future outlook of the overall U.S. economy?

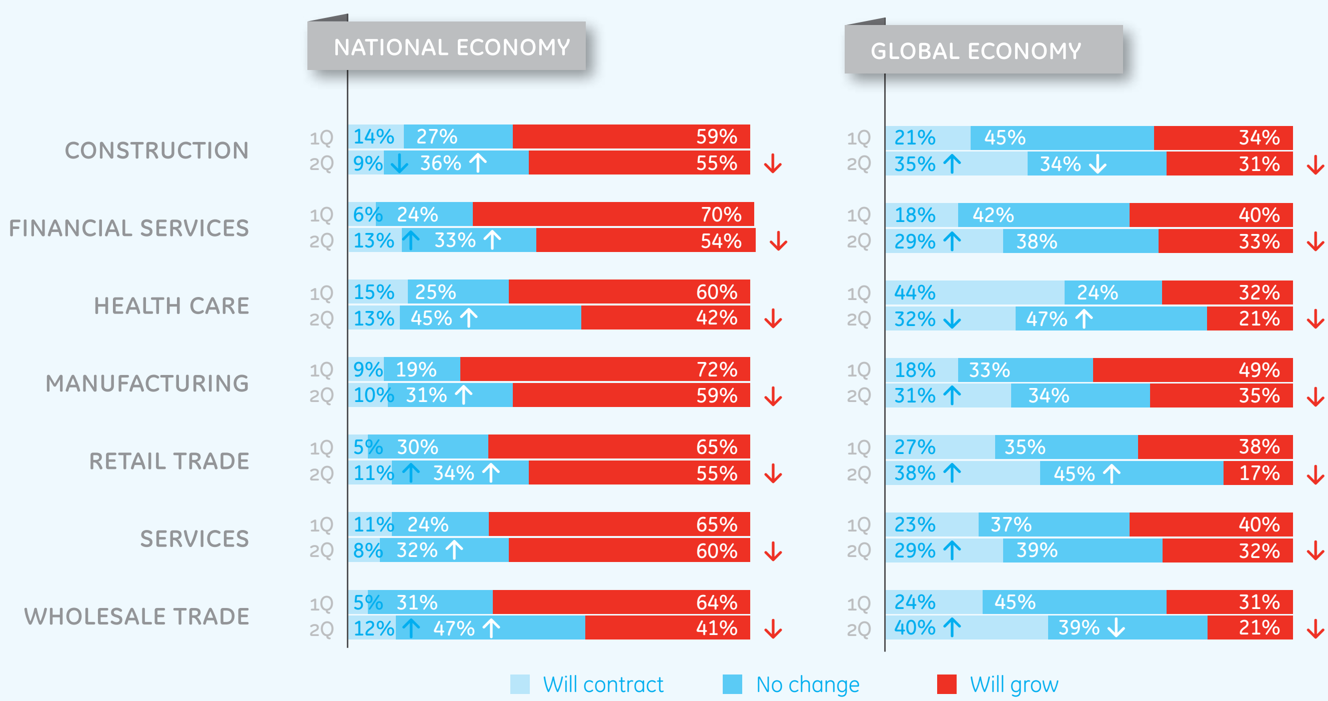
Economic growth outlook

Pessimistic assessments about economic growth abound.



Economic growth outlook by industry

Pessimism is evident across most sectors of the middle market.



Q8. How would you assess the future outlook of the global economy?
Q9. How would you assess the future outlook of the overall U.S. economy?
Q10. How would you assess the future outlook of your local economy?

detailed research findings:
challenges

The biggest challenge for middle market companies remains the cost of health care, with 90% considering it either very or somewhat challenging, about the same as the previous quarter. This concern remained prominent across size, industry, and confidence level, which is not surprising since there was no change in the status of government action since the first quarter of this year at the time of the survey.

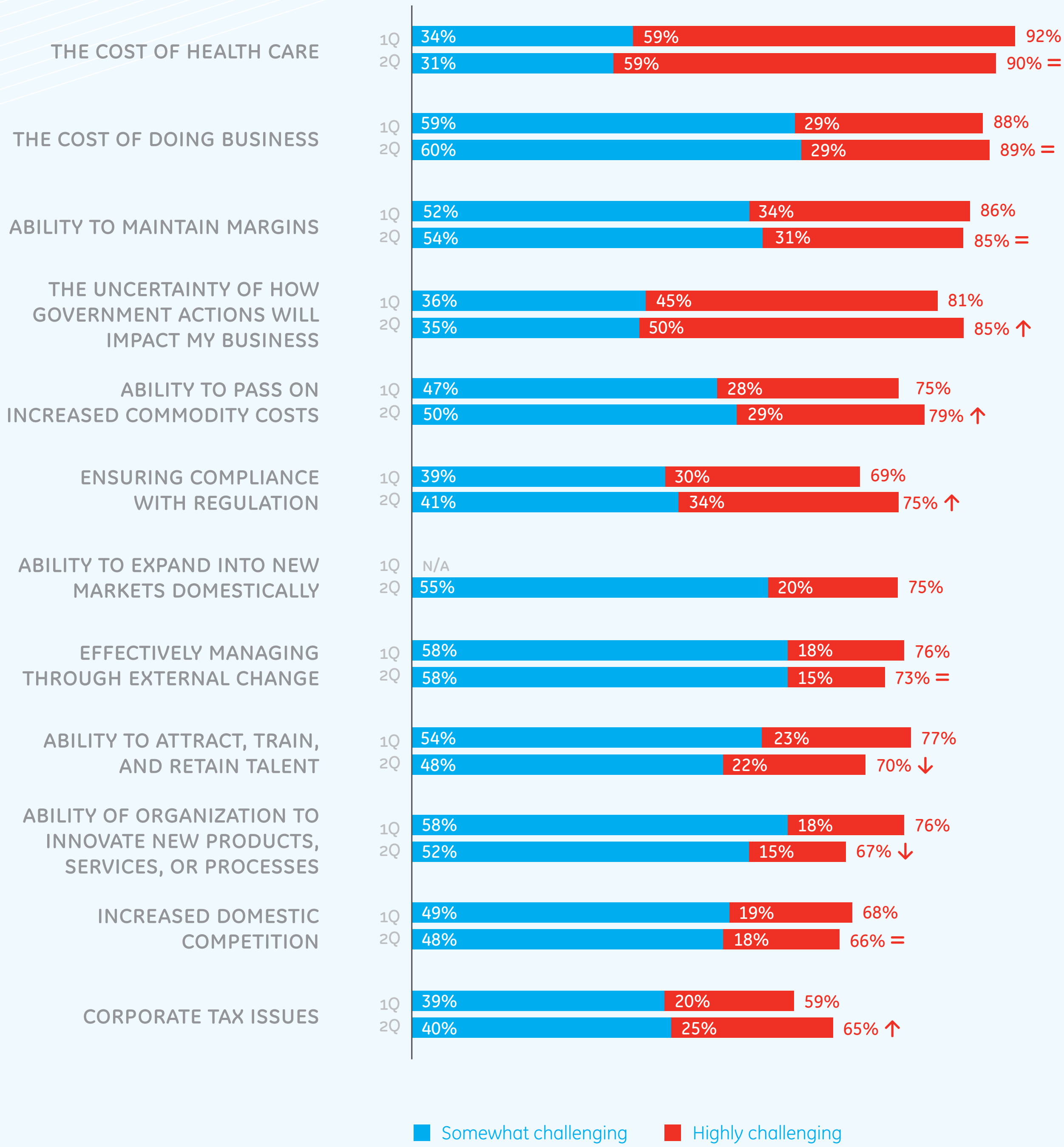
Another challenge cited by middle market companies of all sizes was regulatory in nature, involving factors largely out of their control. Uncertainty about how government actions will impact their business was cited by 85% of companies as either very or somewhat challenging, an increase from 81% in the first quarter. Of those, 50% considered it very challenging—up from 45% a quarter ago—showing that lack of clarity is becoming an even larger problem for the middle market.

Closely following health care are concerns surrounding the cost of doing business, with 89% of executives deeming it very or somewhat challenging. Company leaders are feeling the pressure of these increased costs on their margins, with 79% of survey respondents calling it very or somewhat challenging to pass those costs onto consumers.

The issue of corporate taxes was also cited more this quarter. On the whole, it rose to 65% from 59%, as uncertainty around government actions remains high.

Key challenges

Health care costs and other margin pressures are most challenging to middle market leaders. Regulation and uncertainty of government actions are also key issues.



Q11b. Shown (above) are different challenges confronting businesses. Please indicate how much of a challenge each is for your business.

middle market performance perspective

Despite headwinds and moderating confidence, middle market companies still anticipate both impressive revenue growth and continued hiring over the next 12 months.

As revenue expectations for middle market companies drop to a 4.8% annual growth rate from 5.2% in the first quarter, we expect economic recovery for the U.S. to remain anemic. This is corroborated by employment data. Employment growth for the segment is expected to slow slightly, with expectations of growing employment by 1.8% for the next 12 months relative to 2.0% for the previous 12 months.

If there is a silver lining in these data for the middle market companies, it is their performance relative to other segments. Growth expectations for revenues for large firms are lower, with firms in Standard and Poor's 500 predicting around 4% growth.[5] Similarly, middle market firms are generating employment at twice the rate of large and small firms. While middle market firms grew employment by 2%, larger and smaller firms grew at only 1% in the last 12 months.[6] Though subdued, middle market firms deserve attention because they continue to be the leading segment by many measures, and because they represent a significant component of the U.S. economy. Middle market firms account for nearly one-third of the non-government GDP and private sector jobs.

The ability of middle market companies to continue to grow and to outperform other segments, despite uncertainties related to government action and the global economy, is a testament to structural and operational distinctions of middle market companies that include:

OWNERSHIP

Only 14% of middle market companies in our survey are publicly listed, compared with 67% of large corporations.[7] This allows leadership to be more autonomous and maintain longer-term focus without the pressures of quarterly earnings reporting required of publicly listed corporations.

INSULATION

Middle market companies are less exposed to the global economy, with only 27% of them operating globally versus 60% of large corporations. About 23% of middle market companies source globally versus 9% of large corporations.[8]

DIVERSIFICATION

The middle market is more balanced across industry type and geography than either large or small companies, helping minimize exposure to U.S. economic shocks. Large companies are more reliant on manufacturing and more likely to be located in the Midwest and West. Small companies are highly dependent on the services sector, with almost one-fourth operating in the Southeast.[9]

These advantages have helped the middle market outperform large and small businesses during the recent financial crisis. From 2007 to 2010, the middle market added an average of 20 jobs per business compared with a loss of an average 2,000 jobs per large company.

Middle market companies' relative insulation from the broader economy is particularly important since U.S. corporate profits from abroad dropped **$48.1 billion in the first quarter.**[10] That's a 12% drop from last year's first quarter, showing how declines in the global economy are affecting the profitability of U.S. companies. The middle market is poised to remain an important contributor to economic growth since these firms are less exposed to global markets. But, they remain vulnerable to risks arising out of the uncertainties of government actions.

5 Bloomberg forecast
6 ADP Jobs Report; Large (small) firms are those with >500 (<50) employees
7 Dunn & Bradstreet
8 Dunn & Bradstreet
9 Dunn & Bradstreet
10 U.S. Department of Commerce, Bureau of Economic Analysis release June 28, 2012

appendix

Explaination of revision in 1Q numbers (p. 4):

Revisions to the 1Q mean revenue and employment scores have been adjusted using the Winsorization Method to adjust outlier values in the distributions. The extreme values have been *replaced by* trimmed minimum and maximum values (representing the middle 95th percentile of each overall distribution within the survey instrument). In addition, the means have also been rebased so that they are reflective of the Middle Market as a whole and not solely the proportion of the market experiencing growth or contraction.

NATIONAL CENTER FOR THE MIDDLE MARKET

www.middlemarketcenter.org

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.

THE OHIO STATE UNIVERSITY FISHER COLLEGE OF BUSINESS

Fisher College of Business at The Ohio State University is dedicated to training the next generation of business professionals through world-class faculty and a highly innovative curriculum elevated by close partnerships with industry leaders. The market has spoken: a recent survey of corporate recruiters conducted by *The Wall Street Journal* ranked Fisher second in the nation among business schools with the most sought-after graduates. Stay connected to Fisher via Twitter.

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