4Q 2015

MIDDLE MARKET INDICATOR

SLOWER BUT SUSTAINED GROWTH

NATIONAL CENTER FOR
THE MIDDLE MARKET

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

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

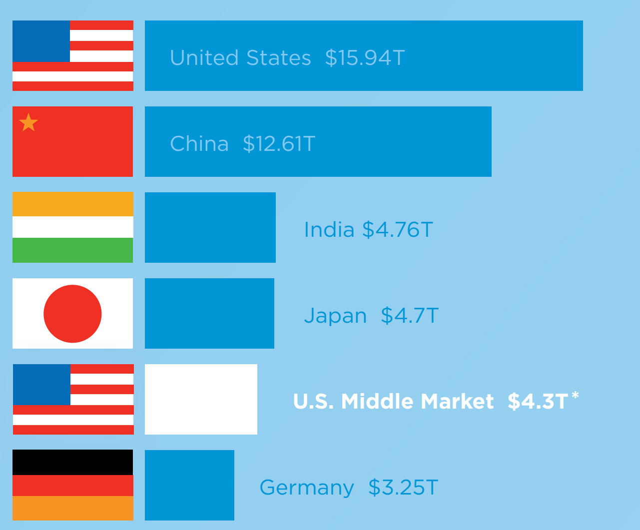
$ LOWER MIDDLE MARKET
$10MM - $50MM

$ $ CORE MIDDLE MARKET
$50MM - $100MM

$ $ $ UPPER MIDDLE MARKET
$100MM - $1B

NEARLY
200,000
BUSINESSES

5TH LARGEST
GLOBAL ECONOMY



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

Executive Summary

Since the end of 2014, U.S. middle market business leaders have forecast a slowdown in the rate of both revenue and employment growth. At the end of 2015, those expectations have materialized, indicating that the middle market has moved from a period of accelerated growth to a steadier, more sustained rate of expansion.

While middle market businesses continue to grow, and to grow faster than their larger counterparts, year-over-year growth rates slowed for Q4 2015. Expectations for growth in 2016 remain stable relative to last quarter, but they continue to be muted, and the outlook for short-term sales and demand has declined. These slowdowns cut across all industries and revenue segments. However, declines are most pronounced among the smallest middle market firms (revenue between $10 million and $50 million), while the largest mid-sized businesses (revenue between $100 million and $1 billion) have maintained relatively steady performance throughout 2015.

The majority of middle market companies in most industries and all revenue segments continue to report improved company performance versus one year ago. However, the proportion of companies reporting improved performance dropped significantly in Q4 2015 to 57%, down from 70% reported at the end of 2014. The smallest middle market companies and businesses in the financial services and retail trade sectors are most likely to have subdued perceptions of company performance.

Nearly 70% of companies continue to report year-over-year revenue increases, a percentage that has remained about the same throughout 2015. However, the rate of past-year revenue growth dropped to 6.1% after remaining near or above 7% for the past 12 months. The smallest middle market companies drove the decline. Still, the middle market outperformed the S&P 500, which experienced -9.6% revenue growth for the same period.

As with revenue growth, the rate of employment growth experienced a downward trend in 2015, but at a more gradual pace. Compared to the end of 2014, the proportion of firms indicating workforce growth is down 10 percentage points for Q4 2015. However, rate of employment growth, while down slightly for the overall middle market in the fourth quarter, has remained fairly consistent throughout the year at around 4%.

Looking ahead, fewer than one in five business leaders expect a more favorable business climate in the next three months. However, more than twice as many—or 38%— expect an increase in short-term sales. Most middle market business leaders believe costs will remain the same for the time being, and the majority of companies will maintain the current size of their workforce, at least through the first quarter of 2016.

Since dropping last quarter, the outlook for revenue growth in the next 12 months remains muted. At the end of 2014, companies optimistically projected 6% revenue growth for the year ahead; actual growth in 2015 met or exceeded those expectations. Today, companies foresee future revenue growth of just 3.7%. Similarly, expectations for future hiring fell to 3.2% at the beginning of 2015 and have remained relatively consistent throughout the year.

As the middle market continues to grow slowly but steadily in the year ahead, companies will continue to contend with staffing issues, government regulations, and competition—key challenges they have faced all year long. Companies also anticipate pressure on profit margins in the coming year.

REVENUE GROWTH

Healthy growth continues, but at a notably slower rate

More than two-thirds (69%) of middle market firms report year-over-year revenue increases for Q4 2015. The rate of growth remains healthy at 6.1%, however, it is more than one full percentage point lower than what was reported at the end of 2014. While the largest middle market firms have maintained relatively steady revenue growth since the end of last year, the smallest middle market firms saw a decreased in the rate of growth from 6.3% at the end of 2014 to 4.7%.

Half of middle market businesses say they will grow revenues in the coming year. Revenue projections for the next 12 months have remained around 4%--about the same as last quarter but significantly lower than projections six months ago. The smallest middle market firms have the lowest expectations for future growth, and firms in every industry have scaled back their growth projections since the beginning of 2015.

4Q'15 **69%** of middle market companies reported positive revenue growth. 4Q'14 73%

MIDDLE MARKET

PAST 12 MO.

4Q'15 **6.1%**

3Q'15 7.2% 4Q'14 7.2%

NEXT 12 MO.

4Q'15 **3.7%**

3Q'15 4.1% 4Q'14 6.0%

S&P 500

PAST 12 MO.

4Q'15 **-9.6%***

3Q'15 -6.2% 4Q'14 4.9%

EMPLOYMENT GROWTH

Employment growth slows marginally

The proportion of firms increasing their workforce compared to one year ago has continued to decline slightly to 39%, compared to 42% last quarter. The rate of employment growth also receded gradually throughout 2015 with firms reporting 3.6% past year employment growth for the fourth quarter. From an industry perspective, services, manufacturing, wholesale trade, and financial services have most notably slowed employment growth. Conversely, job growth in the construction and retail trade industries has increased slightly since the end of 2014.

Looking forward, nearly one-third of middle market firms expect to grow the size of their workforce in the coming year. These companies anticipate increasing employment by a rate of 2.7%. The largest middle market companies have the greatest hiring expectations. Retailers have the most bullish outlook on hiring.

4Q'15 **32%** of middle market companies expect to add jobs. 4Q'14 52%

MIDDLE MARKET

PAST 12 MO.

4Q'15 **3.6%**

3Q'15 4.1% 4Q'14 5.0%

NEXT 12 MO.

4Q'15 **2.7%**

3Q'15 3.2% 4Q'14 4.0%

ADP [PAST 12 MO.]

LARGE CORP.

4Q'15 **2.0%**

3Q'15 1.7% 4Q'14 2.2%

SMALL BUS.

4Q'15 **2.2%**

3Q'15 2.4% 4Q'14 2.2%

**4Q numbers include only companies who have reported 4Q earnings results. Numbers change as more businesses report financial results.*

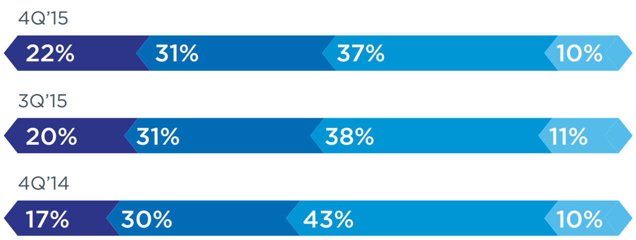
ECONOMIC CONFIDENCE

Confidence is tapering off but remains strong nationally and locally

Since peaking in early 2015, confidence in the global, national, and local economies has declined throughout the year. Fewer than half (47%) of middle market leaders express confidence in the world economy, while close to a quarter (22%) of leaders say they are not confident at all in the state of international affairs. For domestic firms, political uncertainty, homeland security, and threats abroad have the greatest impact on global confidence. Businesses that source one-fifth or more of their revenue internationally are more concerned with cybersecurity threats and weakness in the Eurozone economies.

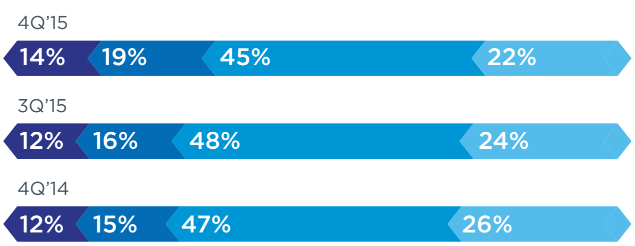
Nationally and locally, confidence remains relatively high, with more than two-thirds (67%) of leaders expressing confidence in the national economy and upwards of three-quarters (76%) of leaders feeling optimistic about the local environment. However, confidence in both areas is waning. U.S. economic confidence for Q4 2015 is 13 percentage points lower than reported at the start of the year.

GLOBAL ECONOMY



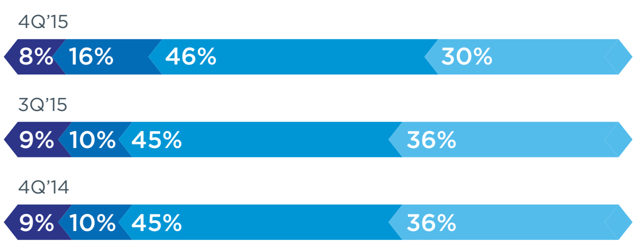
4Q'15
47%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'15 49% 4Q'14 53%

NATIONAL ECONOMY



4Q'15
67%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'15 72% 4Q'14 73%

LOCAL ECONOMY



4Q'15
76%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'15 81% 4Q'14 81%

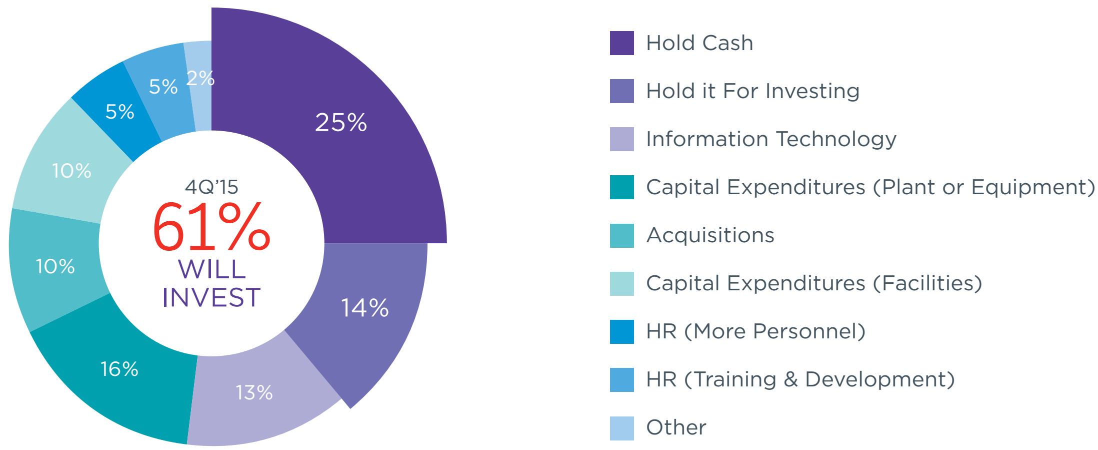
Not confident · Somewhat not confident · Somewhat confident · Confident

CAPITAL INVESTMENT

Firms are less likely to invest

The proportion of middle market firms willing to invest extra money has declined since the end of 2014. Currently, six in 10 companies (61%) say they would allocate extra dollars toward investments while nearly four in 10 (39%) plan on keeping cash. Since declining significantly at the beginning of the year, the percentage of firms planning on expansion in the next 12 months has remained steady throughout 2015, although slightly fewer firms have plans to introduce a new product or service. Those middle market companies that do have expansion aspirations for 2016 are most likely to launch new offerings or expand into new domestic markets. However, regulations and competition continue to present obstacles to expansion.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES

Businesses continue to contend with staffing issues and regulatory burdens

Throughout 2015, training and retaining qualified employees has been a top internal challenge for the middle market. More than half of firms say staffing issues will affect performance in the short term, and nearly as many believe staffing will be an issue all year long. Middle market companies rely on their reputations and benefits packages to attract employees, and they primarily leverage salary increases and flexible work arrangements to keep people onboard. Uncertainty over government actions coupled with increasing competition remain the top external challenges both near and long-term. Three-quarters of firms believe that state and federal regulations have at least some negative impact on business performance.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	60%
2. STAFF/EMPLOYEES	51%
3. COSTS	23%
4. GOVERNMENT	13%

EXTERNAL CHALLENGES:

1. BUSINESS	34%
2. GOVERNMENT	22%
3. COMPETITION	21%
4. ECONOMY	16%
5. COSTS	12%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. STAFF/EMPLOYEES	45%
2. BUSINESS	38%
3. COSTS	19%
4. GOVERNMENT	6%

EXTERNAL CHALLENGES:

1. BUSINESS	29%
2. GOVERNMENT	19%
3. COMPETITION	18%
4. ECONOMY	16%
5. COSTS	11%

Perspectives

GROW YOUR OWN, OWN YOUR GROWTH

In the twelve months ended November 2015, the U.S. private sector added 2.5 million jobs, a 2.1% increase to 120.9 million, according to the St. Louis Fed. Middle market companies, which employ about a third of private-sector workers, added to payrolls at a 3.6% rate in the same period, according to the latest Middle Market Indicator. That translates into approximately 1.4 million new jobs, more than half the total.. If U.S. private employment as a whole had grown that fast, an additional 1.8 million people would have jobs today.

As the most aggressive hirer, the middle market feels the most pressure from the fact that U.S. unemployment has fallen to 5%. Finding, retaining, and developing staff is the top long-term challenge middle-market executives cite. It is complicated by the fact that millennials comprise the largest pool of potential talent. Six out of seven middle market leaders say that millennials pose a challenge of one kind or another; primarily, companies find it hard to attract them in the first place and have doubts about their long-term commitment. These sentiments vary little across industries or by company size. Improved salaries and more flexible work arrangements are the most widely used tools to improve attraction and retention, but . executives also say that company reputation trumps any specific program. That being so, the single best thing companies can do to attract and keep talent is to grow.

WHAT'S AHEAD?

We should keep past performance in mind when looking at this quarter's MMI. The U.S. has experienced 78 straight months of economic growth; by March, assuming growth continues, this expansion will move into third place in history, passing the one fueled by World War II. It's unsurprising that the rates of growth in revenue and employment have slowed; this is typical of long expansions. The absolute numbers, however, remain impressive, and confirm the middle market's role as the most powerful engine of growth in the American economy—and by extension, the world.

From the perspective of several years—this is our 16th quarter of data—we see another characteristic of the middle market: a combination of resilience and agility. It's an oversimplification, but a useful one, to say that big companies are resilient—they can take a punch—but not quick. Small businesses are agile but fragile: Only 57% survived the 2008-2010 crisis, our analysis shows, compared to 82% for the middle market and 97% for large companies. With its combination of agility and resilience, the middle market was first and fastest out of the gate when recovery began six and a half years ago, and has delivered growth above 6% for eight straight quarters.

Macroeconomic indicators are hard to read. On the one hand, U.S. auto sales and holiday retail numbers were strong; however, China's important manufacturing sector continues to weaken. The recent small increase in the Fed rate is more meaningful psychologically than economically—money is about as inexpensive as it has ever been. So, though it (slightly) increases the cost of capital for the middle market, it also indicates that the Fed is more confident.

HOW FAST, HOW HARD?

If tailwinds are uncertain, companies must grow on their own steam, so to speak. In this context, it's notable that the upper middle market—companies with revenues between $100 million and $1 billion—is substantially more likely to invest for future growth by introducing new products or services (45% for the upper middle market, 33% for the core, 32% for the lower), adding plants or facilities (24%, 14%, 14%), and entering new international markets (27%, 14%, 11%). R&D spending as a percentage of revenue follows the same pattern: From big to small, it is 11.3%, 10.5%, and 7.9%. All of these numbers declined during the course of 2015, but they have fallen off more for the smaller companies.

It is consequently not surprising that the upper middle market delivered the strongest performance in 2015 and expresses the most confidence about the year to come.

	$100M-$1B	$50M-$100M	$10M-$50M
Mean Revenue Growth (Last 12 Months)	7.9	6.7	4.7
Projected Revenue Growth (Next 12 Months)	3.8	3.8	3.5
Mean Employee Growth (Last 12 Months)	5.2	3.2	2.5
Projected Employee Growth (Next 12 Months)	3.9	2.1	2.0

Lower middle market companies appear to have used their profits to pay down debt: 37% say they carry less debt than a year ago, vs. 31% for large middle market companies. Going forward, 23% of larger companies say they intend to take on new debt this year, compared to just 13% for the lower middle market.

These numbers add nuance to a pattern we have noticed before. In general, middle market executives place a premium on keeping their options open. At this juncture, options appear to be dependent on company size. Smaller outfits want to maximize financial options via cash in their wallets, few commitments, and minimal debt. Larger outfits—while significantly more conservative than they were at this time last year—favor investments that create real options, like new products, plants, staff, and markets. The former, presumably, figure that they can make up in agility what they might have short-changed in investment; the latter are putting down bets they expect to cash in.

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From business as usual to business unusual, Fisher College of Business prepares students to go beyond and make an immediate impact in their careers through top-ranked programs, distinguished faculty and a vast network of partnerships that reaches from the surrounding business community to multinationals, nonprofits and startups across the globe. Our students are uniquely prepared and highly sought, leveraging Fisher's rigorous, experiential learning environment with the resources of Ohio State, a premiere research university with 500,000 proud Buckeye alumni.

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