NATIONAL CENTER FOR
THE MIDDLE MARKET

4Q 2016

MIDDLE MARKET INDICATOR

EMPLOYMENT PEAKS, CONFIDENCE SURGES

IN COLLABORATION WITH

The Ohio State University
Fisher College of Business

SunTrust

Grant Thornton

Cisco

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 LLP, 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

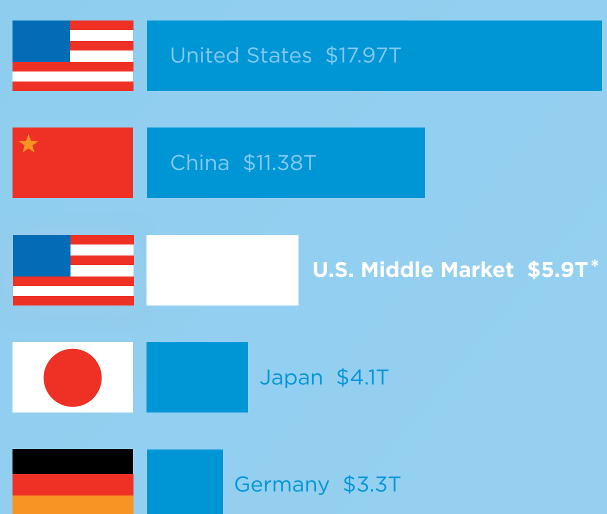
$ LOWER MIDDLE MARKET
$10MM - $50MM

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

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

NEARLY
200,000
BUSINESSES

3RD LARGEST
GLOBAL ECONOMY



*Source: 2015 CIA World Fact Book (not adjusted for purchasing power parity), *National Center for the Middle Market (estimate)*

Executive Summary

The middle market ended a strong year on a strong note with year-over-year revenue growth rates above the five-year average and employment growth rates at an all-time high since the inception of the Middle Market Indicator five years ago. Companies report the highest economic confidence levels to date and most businesses remain willing to invest. Business leaders look forward to a prosperous 2017, with the majority expecting revenue growth to continue its upward trend. However, employment growth rates are expected to moderate somewhat, especially as companies continue to struggle with talent management issues including recruiting and retention. Other anticipated headwinds include challenges maintaining growth and managing capital as well as government rules and regulations.

Most companies (61%) continue to say that overall firm performance has improved since a year ago, up from 57% at the end of 2015. Fewer than one in 10 companies report deteriorating conditions. Companies believe they perform the best in areas such as maintaining banking relationships, retaining profitable customer accounts, being a leader in their industries, and managing cash flow. They see room for improvement when it comes to innovation, workforce issues, and managing healthcare costs.

Year-over-year revenue growth is up to 6.9% from 6.3% last quarter, with a higher percentage of companies reporting revenue increases. The largest middle market businesses (with revenues between $100 million and $1 billion), in particular enjoyed a successful year, with close to eight in 10 (78%) of these firms reporting revenue growth at a mean total growth rate of 8.1%. Forty-eight percent of middle market companies grew through expansion into a new market in 2016, with 32% entering a new domestic market and 16% entering a new international market. Four in 10 companies introduced a new product or service this year, and those new offerings accounted for more than 20% of revenues for about a quarter of middle market businesses, making innovation a crucial factor in growth. Few middle market companies view using debt to fund growth, and just 12% of companies took on new debt or opened a new line of credit in 2016.

As has been the trend all year, businesses once again report an increase in year-over-year employment growth. At 5.4% for Q4 2016, employment growth rates are at the highest level since the MMI began measuring and reporting growth rates in 2012. Middle market companies contend that hiring new talent is critical to innovation. Overall, 44% of middle market organizations increased employment in 2016, with just over half (51%) of the largest middle market firms increasing staff size.

After a year of building up the workforce, the vast majority of businesses (82%) believe the size of their current staffs is just about right.

While mid-sized businesses in all industries performed well this year, companies in the services and construction industries report the most positive year-over-year revenue and employment growth for 2016. In the service industry, both revenue and employment growth are at their highest reported rates, with 80% of service firms saying year-over-year revenues increased this quarter and 54% saying the workforce has expanded since last year. Similarly, construction companies posted their best numbers in Q4 2016 following a year of acceleration. With year-over-year revenue growth of 12.6% and employment growth of 9.3%, construction firms boast the highest numbers in the middle market.

The short-term outlook among middle market business leaders is the best it has been in two years, especially among the largest middle market companies. A greater percentage of firms expect both sales and demand to increase in the next three months, and more than a quarter (28%) of companies anticipate a more favorable business climate by the end of next quarter. About three in 10 (29%) companies plan to increase their workforce in the short term.

For the full year ahead, middle market companies will continue to be the lifeblood of the U.S. economy. Companies continue to anticipate increases in revenue growth. More than four in 10 firms expect to introduce a new product or service and/or expand into new domestics markets in 2017. They also expect profit margins to increase slightly while costs remain stable, and more than one-third of businesses intend to increase their prices over the next 12 months.

From an employment perspective, businesses say hiring will continue to increase. However, the projected rate of employment growth is down slightly from last quarter's forecast, except among the largest middle market companies. About one-quarter of executives expect a tighter job market as firms continue to compete for and onboard new employees, and they believe talent issues will remain a key challenge in the year ahead.

Additionally, regulations continue to have a negative impact on company performance for the majority of middle market businesses. Business leaders say costs will also be an issue in 2017, particularly healthcare costs, and energy costs to a lesser extent.

REVENUE GROWTH
Revenue growth rebounds and will continue to rise

Year-over-year revenue growth fluctuated in 2016, but companies ended the year reporting a growth rate of 6.9%, an increase from last quarter and slightly above the five-year average rate of 6.5%. Overall, more middle market companies reported year-over-year revenue increases this quarter compared to Q3. Businesses with revenue of $50M or more drove the increases while the rate of growth among the smallest middle market firms (with revenues between $10 million and $50 million), dipped slightly.

While actual growth rates have seesawed this year, projections for future growth have risen each quarter and are now at the highest levels seen in two years. Over half (56%) of middle market firms say gross revenue will increase at an expected rate of 5.5% in 2017. Based on the average understatement of projected growth compared to actual growth, revenue growth by the end of next year could reach a rate of 7.1%.

4Q'16 **70%** of middle market companies reported positive revenue growth. 4Q'15 69%

MIDDLE MARKET

PAST 12 MO.

4Q'16
6.9%
3Q'16 6.3% 4Q'15 6.1%

NEXT 12 MO.

4Q'16
5.5%
3Q'16 4.9% 4Q'15 3.7%

S&P 500

PAST 12 MO.

4Q'16
4.4%*
3Q'16 2.5% 4Q'15 -9.6%

EMPLOYMENT GROWTH
Employment growth peaks, but may taper off

More than four in 10 companies (44%) say employment increased in 2016, while just 12% report a decrease in headcount. Those businesses that hired have added jobs at increasingly faster rates. At 5.4%, the year-over-year employment growth for Q4 2016 is at the highest level since the inception of the MMI five years ago. In fact, throughout 2016, year-over-year growth rates escalated each quarter, and they have remained above the five-year historical average of 3.4% all year long.

For 2017, companies expect the rate of employment growth to moderate somewhat. A third of companies say they will add jobs at a rate of 3.4% over the next 12 months, a decrease from the 4.0% projected last quarter. Businesses will primarily add full-time positions with an emphasis on operations, marketing, and sales jobs. The largest middle market firms expect to add jobs in IT, also.

4Q'16 **33%** of middle market companies expect to add jobs. 4Q'15 32%

MIDDLE MARKET

PAST 12 MO.

4Q'16
5.4%
3Q'16 4.9% 4Q'15 3.6%

NEXT 12 MO.

4Q'16
3.4%
3Q'16 4.0% 4Q'15 2.7%

ADP [PAST 12 MO.]

LARGE CORP.

4Q'16
2.4%
3Q'16 2.3% 4Q'15 2.0%

SMALL BUS.

4Q'16
1.4%
3Q'16 1.8% 4Q'15 2.2%

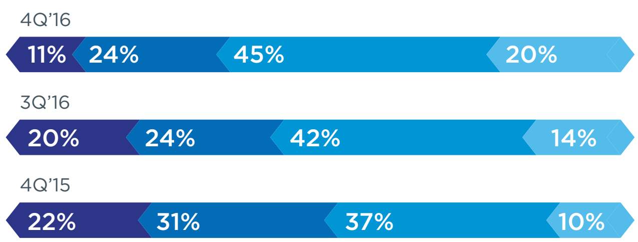
**4Q numbers include only companies who have reported 4Q earnings results. Numbers change as more businesses report financial results.*

ECONOMIC CONFIDENCE
Confidence soars

Measured just weeks after the 2016 U.S. presidential election, confidence levels in the global, national, and local economies is at the highest levels recorded by the MMI. Confidence has been trending up since Q2 2016 with more than eight in 10 companies reporting positive perceptions of their U.S. and metro area economies at the close of the year. A solid majority (65%) also say they are satisfied with the global state of affairs, representing a significant 18-point jump in global economic confidence since the end of 2015.

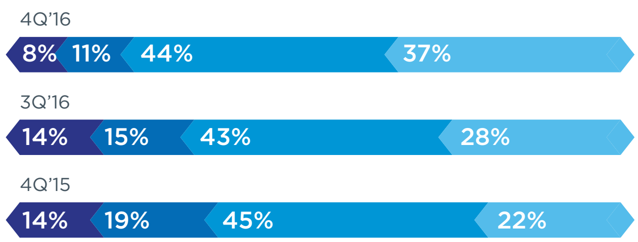
Companies with the fastest rates of growth are moving the needle on confidence. Those firms that are most positive about the global situation enjoyed a revenue growth rate of 13.2% and an employment growth rate of 13.9% in 2016. Similarly, businesses that are most positive about the United States economy reported high year-over-year growth rates: 9.5% and 9.4% for revenue and employment respectively.

GLOBAL ECONOMY



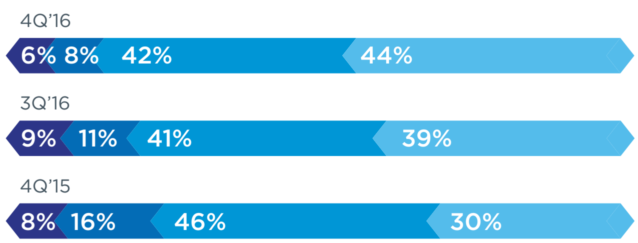
4Q'16
65%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'16 56% 4Q'15 47%

NATIONAL ECONOMY



4Q'16
81%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'16 71% 4Q'15 67%

LOCAL ECONOMY



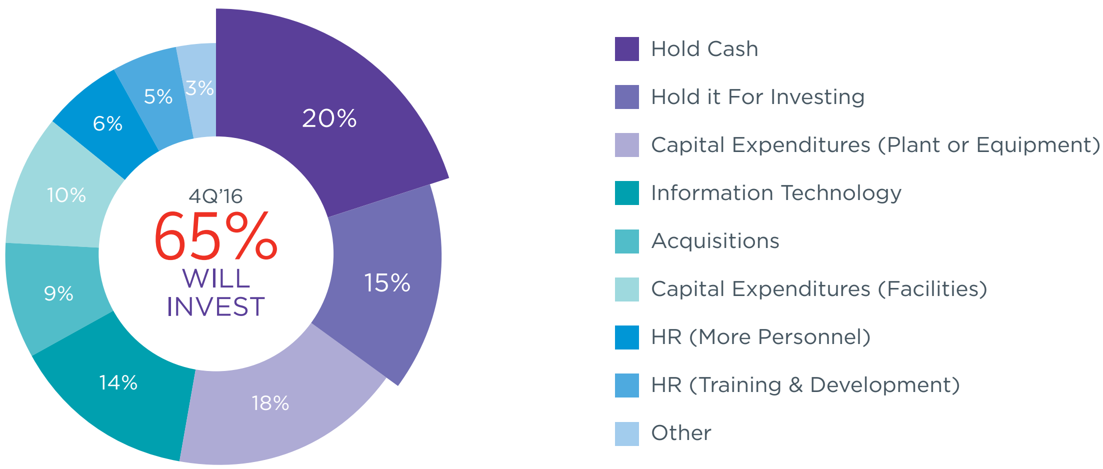
4Q'16
86%
CONFIDENT / SOMEWHAT CONFIDENT
3Q'16 80% 4Q'15 76%

Not confident | Somewhat not confident | Somewhat confident | Confident

CAPITAL INVESTMENT
Investment attitudes remain unchanged

While the majority of middle market businesses say they would an invest extra dollar of revenue, the percentage continues to hover around two-thirds, inching up from 61% at the end of 2015 to 65% for Q4 2016. Just over one-third (35%) of firms continue to say they would hold onto an extra dollar. Among the savers, a little more than half want to build up cash reserves; the remainder say they would save for future financial investments. For the investors, capital expenditures on plant and equipment is the most likely area for spending, with a quarter of companies saying they are highly likely to add a new plant or facility in the next 12 months. Most companies anticipate their capital expenditures to be about the same in 2017 as they were in 2016.

ADDITIONAL INVESTMENT ALLOCATION



KEY CHALLENGES
Concerns about talent and the government persist

As middle market companies strive to grow and perform over the next 12 months, core issues, such as maintaining growth and managing capital, remain the greatest challenges. Talent management continues to be an issue, especially retention and recruitment of professional and technical experts, as firms look to overcome skills gaps and compete with each other for the best people. Many firms are considering improving salaries and offering flexible work arrangements to attract talent. Unease over the government's impact on business, especially related to rules and regulations, has been on the rise since the second quarter of 2016, with a quarter of companies saying the government is a concern.

SHORT TERM CHALLENGES (Next 3 months)

INTERNAL CHALLENGES:

1. BUSINESS	62%
2. STAFF/EMPLOYEES	45%
3. COSTS	21%
4. GOVERNMENT	16%

EXTERNAL CHALLENGES:

1. BUSINESS	32%
2. GOVERNMENT	27%
3. COMPETITION	16%
4. COSTS	15%
5. ECONOMY	14%

LONG TERM CHALLENGES (Next 12 months)

INTERNAL CHALLENGES:

1. BUSINESS	39%
2. STAFF/EMPLOYEES	38%
3. COSTS	16%
4. GOVERNMENT	5%

EXTERNAL CHALLENGES:

1. BUSINESS	28%
2. GOVERNMENT	25%
3. COSTS	13%
4. COMPETITION	12%
5. ECONOMY	12%

Perspectives

The Middle Market Indicator has been in existence for five years–a full 20 quarters. The performance U.S. middle market companies posted in the fourth quarter of 2016 is among the highest we have seen during this stretch: Only six times has annualized revenue growth topped this quarter's 6.9% (the average is 6.5%). The increase in employment, 5.4%, is the highest by far (the average is 3.4%). The short-term index–a blend of expectations for business climate, demand, and sales–is at 81, the highest since the first quarter of 2015. The average middle market company expects its profit margins to increase 3.4% next year, the most we have seen in three years. The market seems ebullient.

THE MIDDLE MARKET DRIVES THE U.S. ECONOMY

In every quarter except one (the first quarter of 2012) middle market revenue growth has outpaced that of the S&P 500, often by huge margins (6.9% to 4.4% in this quarter, for example). Revenue for the middle market increased nearly twice as fast as GDP. While one cannot compare those two numbers one-to-one, the proportion is revealing. So, too, are the employment numbers. By our estimation, the middle market produces three out of five net new private-sector jobs. It is often asserted that small business is the engine of job creation in America; the cliché ignores the fact that small companies, with high failure rates, destroy many jobs as well. Five years of MMI data consistently show the middle market producing jobs one-and-a-half or two times faster than either big or small business.

REVENUE GROWTH IS MOSTLY ORGANIC

Expansion is the single largest source of top-line growth in the middle market. Forty-eight percent of middle market companies said they entered new markets in 2016; 63% expect to in 2017. Of course, mid-sized companies have more room to grow than gigantic companies, which almost by definition have few frontiers left; and smaller companies, while they have plenty of running room, have fewer resources to throw into geographic expansion. (Our studies also show that middle market companies could be more aggressive about international expansion than they are.) The number-two source of growth is innovation. Four out of 10 middle market companies introduced a new product or service in 2016; executives say that number will tick up to 42% in 2017.

Acquisitions play a notably smaller role in middle market growth. In 2016 24% of the middle market either made an acquisition or a sale. The number plunges when you remove companies owned by private equity firms, which buy and sell for a living; of non-PE-owned companies, just 17% were involved in a deal in 2016. The year ahead promises much more action: 39% expect to buy or sell. If that materializes, it will be the highest level of M&A activity we have seen in the two years we have been tracking these data.

The preponderance of organic growth in the middle market model may explain its vigorous job creation. While inorganic growth can have many benefits, deals are often done in pursuit of "synergies"–i.e., cost savings–whereas new markets, products, and services usually mean new hiring

MIDDLE MARKET COMPANIES ARE CONSERVATIVELY MANAGED

MMI data, as well as other NCMM studies, depict a sector that on the whole handles money prudently. Only one company in eight says it took on new debt last year, despite historically low interest rates. This quarter, 35% of executives say they would put aside an additional dollar of revenue as savings or for future use rather than put it immediately to work. Over the history of the MMI, we have seen and remarked on the fact that middle market companies are deliberate about hiring–adding workers even in temporary downswings but cautious about hiring early in an upswing. Robust growth and tight-fisted fiscal management are often thought to be at odds with each other. The middle market, which (mostly) does not need to please or appease public shareholders, appears to be able to able to present both a boring balance sheet and an exciting income statement.

TALENT IS THE MIDDLE MARKET'S BIGGEST CONSTRAINT

It stands to reason that the middle market–the most aggressive hirers–would feel a talent pinch more than others. Indeed, middle market companies rank talent management among their top three challenges more often than they do maintaining growth and managing costs combined. Smaller middle market firms are particularly likely to report difficulty recruiting people with the right skills, but talent is a struggle across the board. Nearly four in 10 companies–37%–say lack of talent constrains their ability to grow. Twenty-five percent say that their biggest recruiting challenge is finding salespeople–which by itself would be an impediment to growth.

Now, for the last five years the U.S. has enjoyed steady and moderate growth, low interest rates, cheap energy, negligible inflation, slower increases in healthcare costs, and little cost pressure from materials or wages. It's unlikely that these favorable conditions will entirely persist. If and as they change, the middle market's challenges will change, too. For now, though, the middle market enters the new year–and the MMI its second half-decade–with the highest levels of confidence it has ever shown.

NATIONAL CENTER FOR
THE MIDDLE MARKET

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

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SUNTRUST

SunTrust Banks, Inc. is a purpose-driven company dedicated to Lighting the Way to Financial Well-Being for the people, businesses, and communities it serves. Headquartered in Atlanta, the Company has three business segments: Consumer Banking and Private Wealth Management, Wholesale Banking, and Mortgage Banking. Its flagship subsidiary, SunTrust Bank, operates an extensive branch and ATM network throughout the high-growth Southeast and Mid-Atlantic states, along with 24-hour digital access. Certain business lines serve consumer, commercial, corporate, and institutional clients nationally. As of September 30, 2016, SunTrust had total assets of $205 billion and total deposits of $159 billion. The Company provides deposit, credit, trust, investment, mortgage, asset management, securities brokerage, and capital market services. SunTrust leads onUp, a national movement inspiring Americans to build financial confidence. Join the movement at onUp.com.

Grant Thornton

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