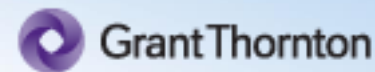


Q4'17 MIDDLE MARKET INDICATOR | ACG WEBINAR | February 8, 2018

THE MARKET THAT MOVES AMERICA

FINDINGS FROM THE NCMM'S Q3'17 INDICATOR SURVEY

Thomas A. Stewart, Executive Director
The National Center for the Middle Market



THE MIGHTY MIDDLE MARKET

U.S. Middle Market Defined

NEARLY

200,000

BUSINESSES

IN ALL INDUSTRY
SEGMENTS AND
GEOGRAPHIES



REPRESENTING

3.0%
OF ALL U.S.
COMPANIES



**ANNUAL
REVENUE**

RANGING FROM

\$10MM-\$1B



U.S. Middle Market Impact



5TH
LARGEST
GLOBAL ECONOMY



33%
OF PRIVATE
SECTOR GDP



GENERATED
AN ADDITIONAL



**\$500
BILLION**



IN ANNUAL
REVENUE IN 2013



MORE THAN

**\$10
TRILLION**

IN ANNUAL REVENUE



1/3

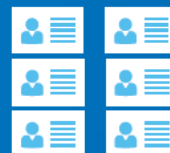
OF U.S. JOBS—
APPROXIMATELY
45.6 MILLION



PROJECTED
TO CREATE



60%
OF ALL
NEW JOBS



2013-2014 CONTRIBUTED
1.1+ MILLION
NEW JOBS

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.

MIDDLE MARKET RESEARCH & DATA



Quarterly Middle Market Indicator



Research and Expert Perspectives



Interactive Benchmarking Tools

EXPERTISE & OUTREACH



Share Research & Discuss Trends

EDUCATION



Executive Programs



Webinars

THE MIDDLE MARKET INDICATOR

MIDDLE MARKET INDICATOR OVERVIEW

A Quarterly National Survey



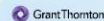
NATIONAL CENTER FOR THE MIDDLE MARKET

4Q 2017

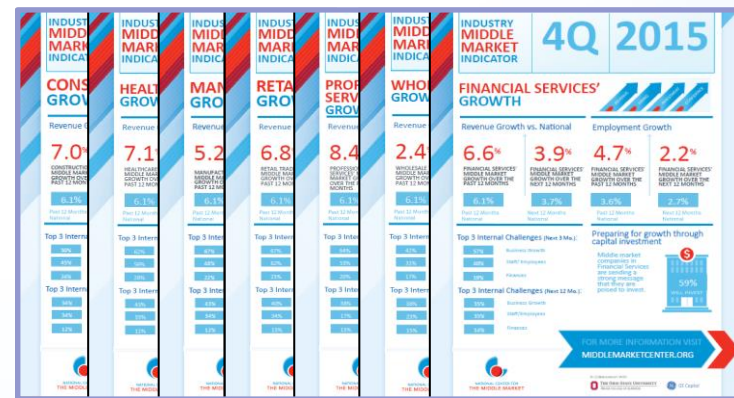
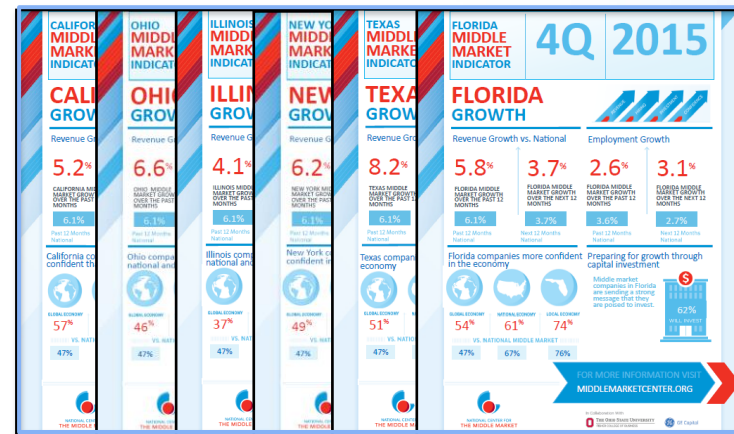
MIDDLE MARKET INDICATOR

GROWTH RETURNS TO TYPICAL LEVELS

IN COLLABORATION WITH



Cut by Geography and Industry



Q4'17 MIDDLE MARKET INDICATOR EXECUTIVE SUMMARY

- 1** THE MIDDLE MARKET CONTINUES TO LEAD THE U.S. ECONOMY IN REVENUE GROWTH AND JOB CREATION, WITH GROWTH ABOVE HISTORICAL AVERAGES
- 2** THE MIDDLE MARKET CONTINUES WITH RECORD HIGH JOB CREATION AND REVENUE GROWTH, FUELED IN PART BY A SURGE IN M&A ACTIVITY
- 3** EXPECTATIONS FOR GROWTH AND JOB CREATION IN THE COMING YEAR ARE ALSO STRONG
- 4** CONFIDENCE IN THE U.S. AND LOCAL ECONOMIES REMAIN NEAR RECORD HIGHS; GLOBAL CONFIDENCE HAS REBOUNDED

Q4'17 U.S. MIDDLE MARKET EXECUTIVE SUMMARY

REVENUE GROWTH

7.6%

PAST 12 MONTHS

6.9%
S&P 500

5.4%

NEXT 12 MONTHS



EMPLOYMENT GROWTH

5.2%

PAST 12 MONTHS

1.4% SMALL BUSINESS
2.6% LARGE BUSINESS

3.7%

NEXT 12 MONTHS



CAPITAL INVESTMENT



Compared to 65%
in 4Q'16

CONFIDENCE

75%

GLOBAL ECONOMY



86%

NATIONAL ECONOMY



88%

LOCAL ECONOMY



Q4'17 MIDDLE MARKET INDICATOR REVENUE GROWTH

PAST 12 MONTHS

7.6%

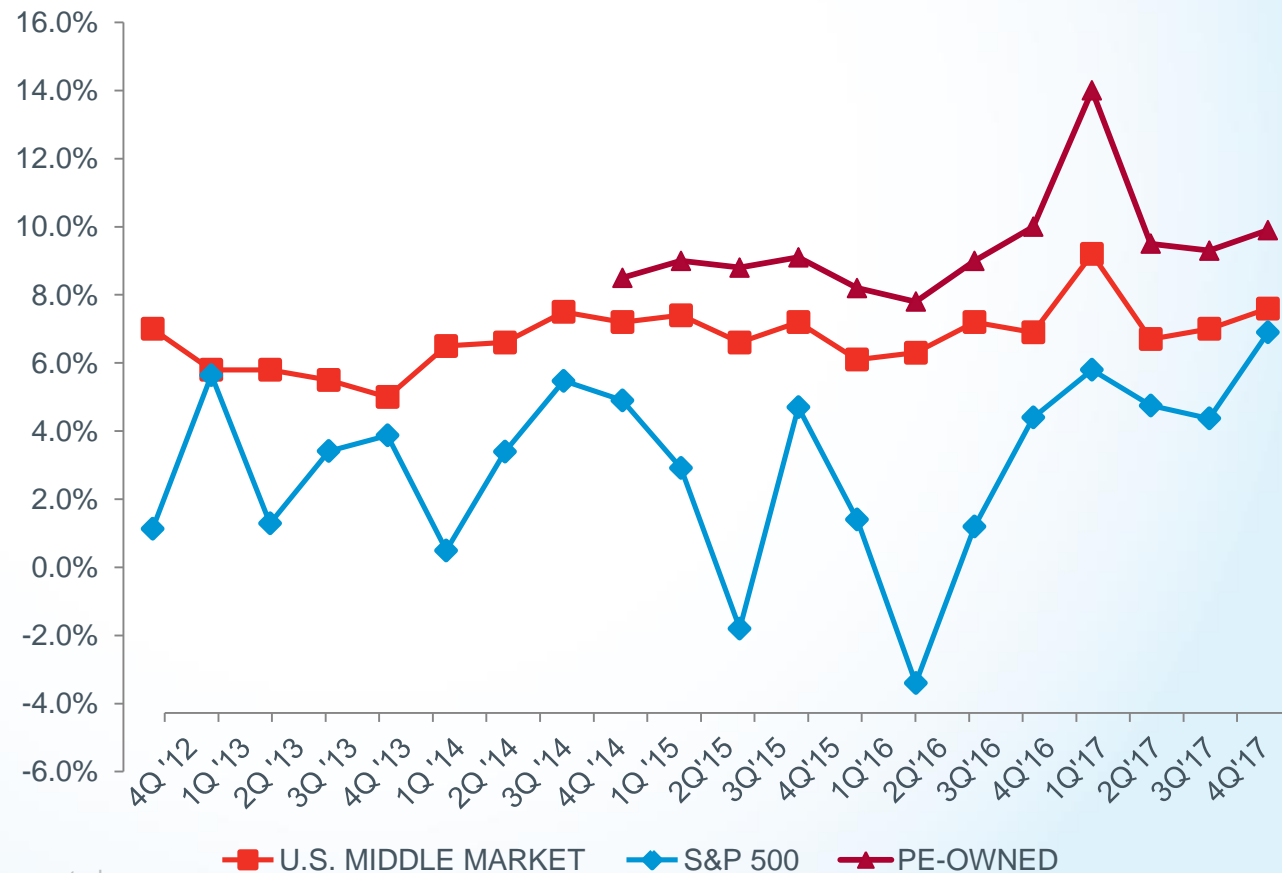
U.S. MIDDLE MARKET

9.9%

PE-OWNED FIRMS

6.9%

S&P 500*



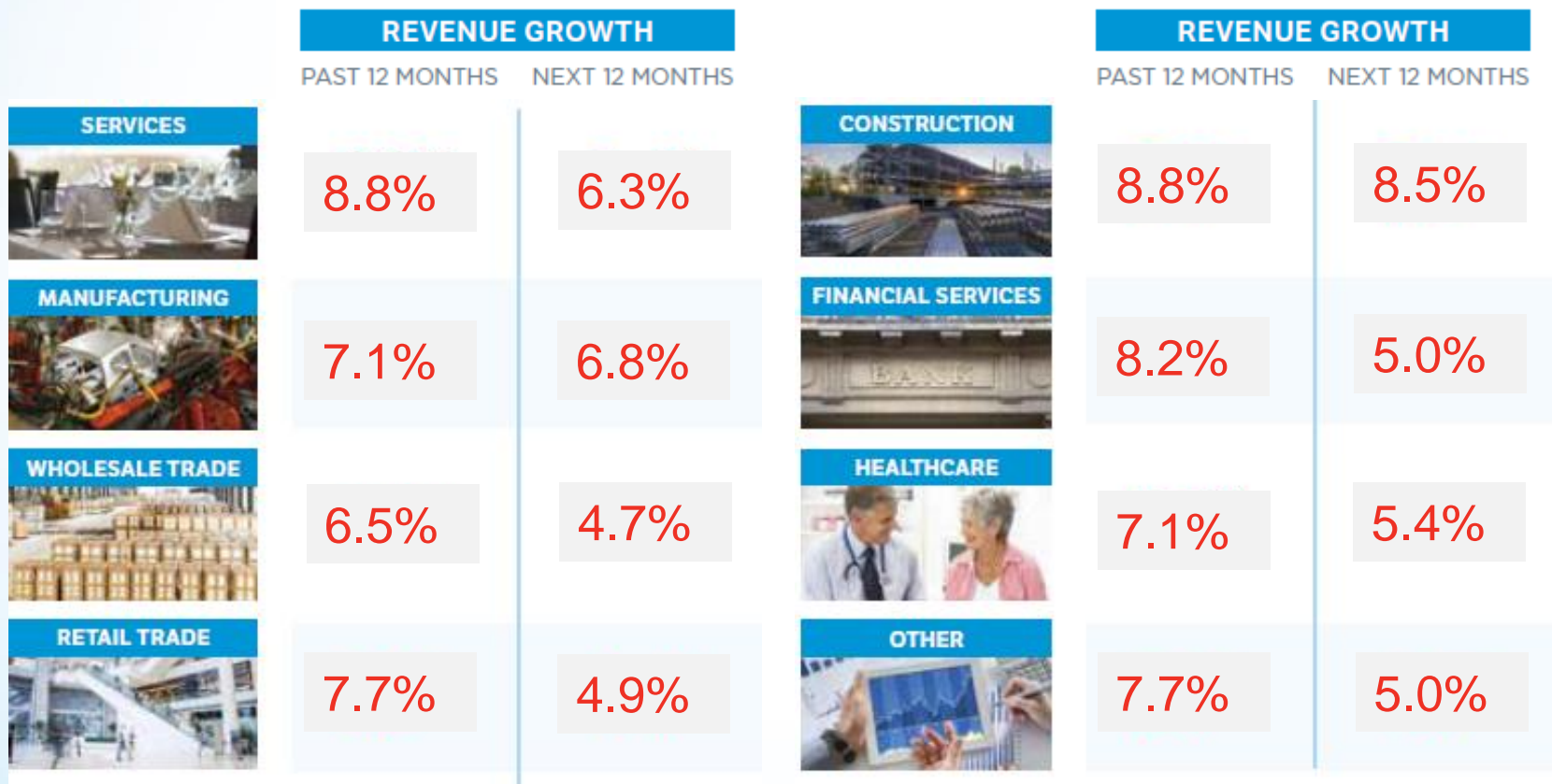
Source: 4Q'17 Middle Market Indicator Report

*4Q numbers include only companies who have reported.

THE RISING TIDE CONTINUES TO LIFT ALMOST ALL BOATS

	4Q 2017	4Q 2016
Performance improved	71%	61%
Performance was unchanged	24	31
Performance deteriorated	5	8

Q4'17 MIDDLE MARKET INDICATOR INDUSTRY REVENUE GROWTH



Q4'17 MIDDLE MARKET INDICATOR REVENUE GROWTH FORECAST

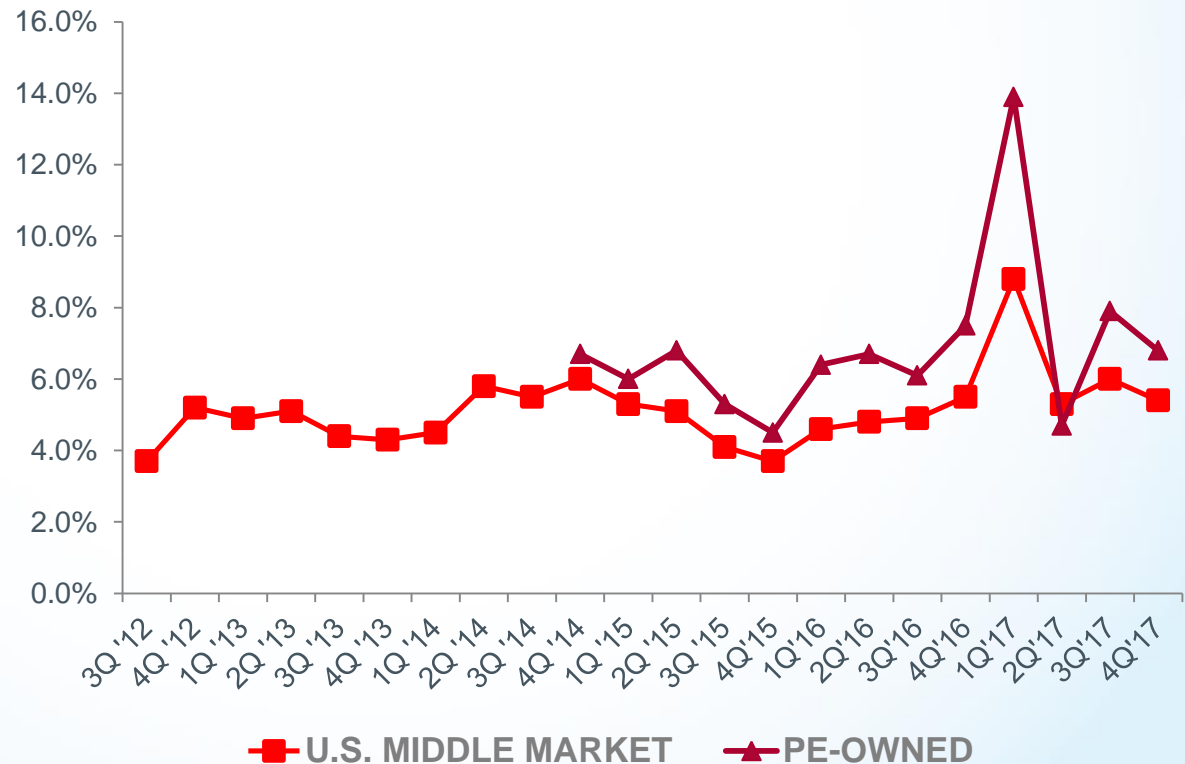
NEXT 12 MONTHS

5.4%

U.S. MIDDLE MARKET

6.8%

PE-OWNED FIRMS



Q4'17 MIDDLE MARKET INDICATOR EMPLOYMENT GROWTH

PAST 12 MONTHS

5.2%

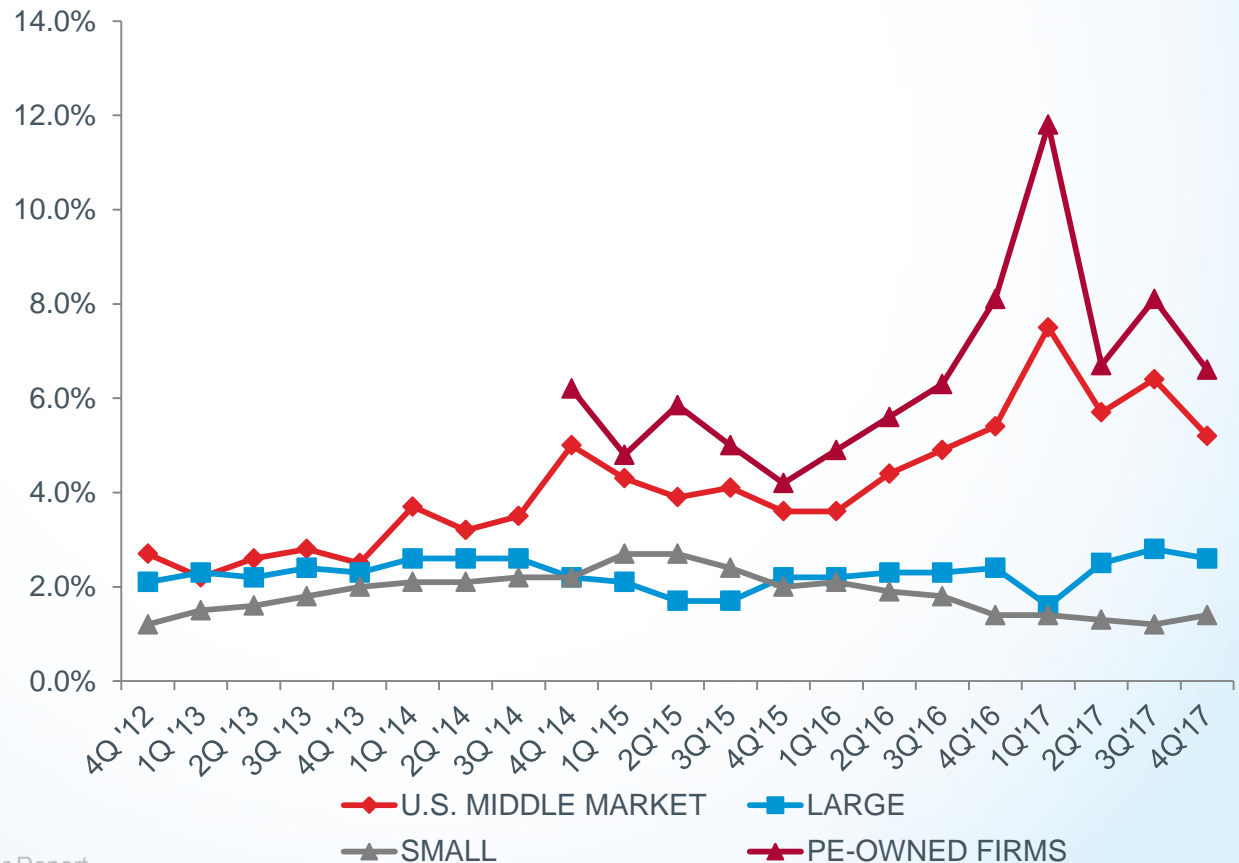
U.S. MIDDLE MARKET

1.4%
SMALL
BUSINESS

2.6%
LARGE
BUSINESS

6.6%

PE-OWNED FIRMS



Q4'17 MIDDLE MARKET INDICATOR INDUSTRY EMPLOYMENT GROWTH



Q4'17 MIDDLE MARKET INDICATOR EMPLOYMENT GROWTH FORECAST

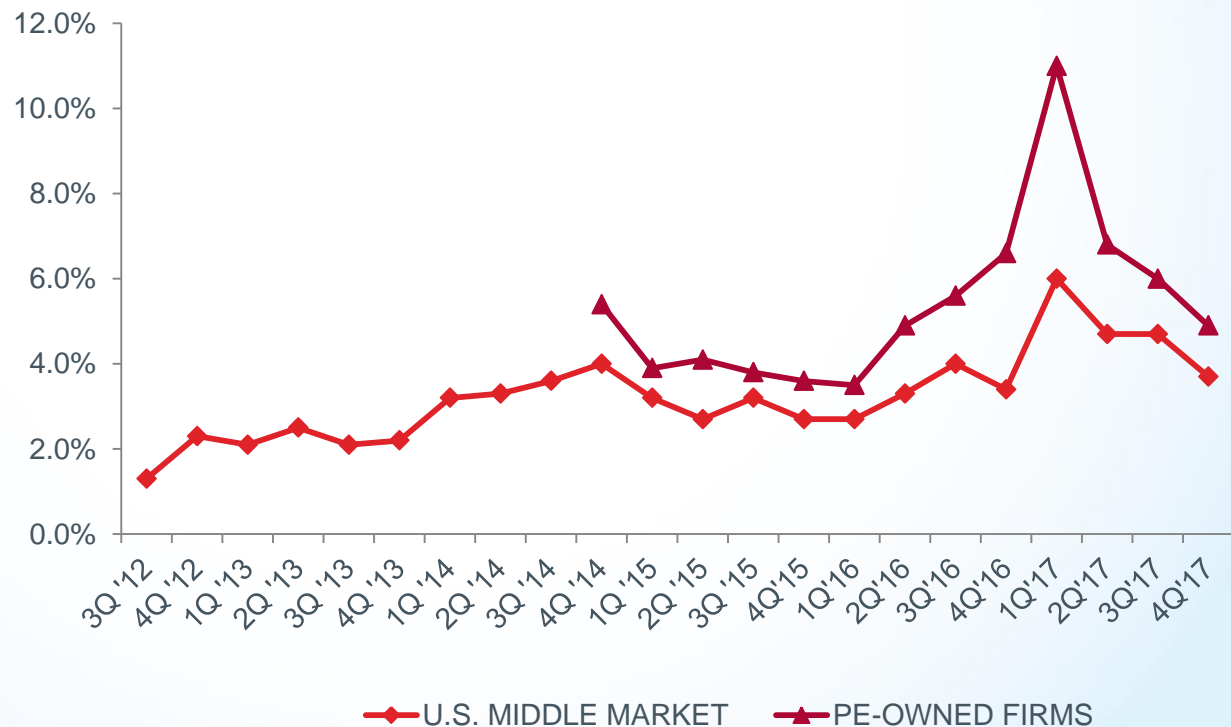
NEXT 12 MONTHS

3.7%

U.S. MIDDLE MARKET

4.9%

PE-OWNED FIRMS

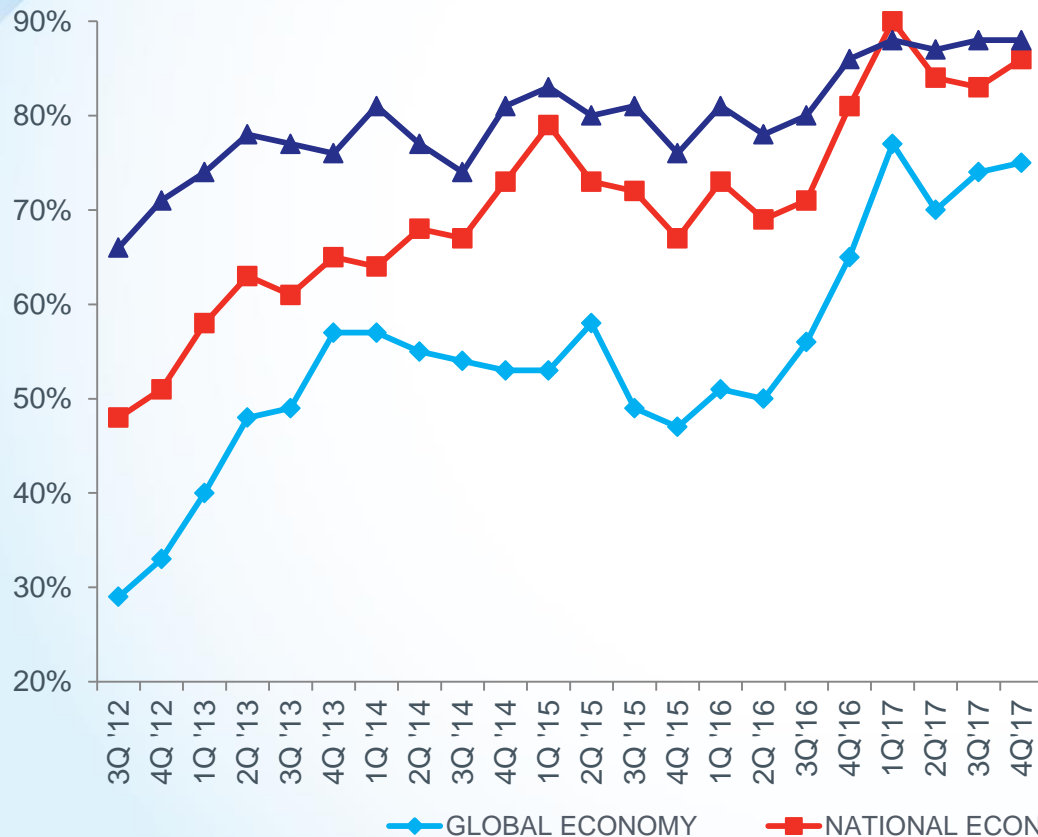




CONFIDENCE, INVESTMENT PLANS, AND CHALLENGES

Q4'17 MIDDLE MARKET INDICATOR ECONOMIC CONFIDENCE

Confidence Remains Strong Across the Board



GLOBAL ECONOMY

75%

78% PE-OWNED



U.S. ECONOMY

86%

86% PE-OWNED



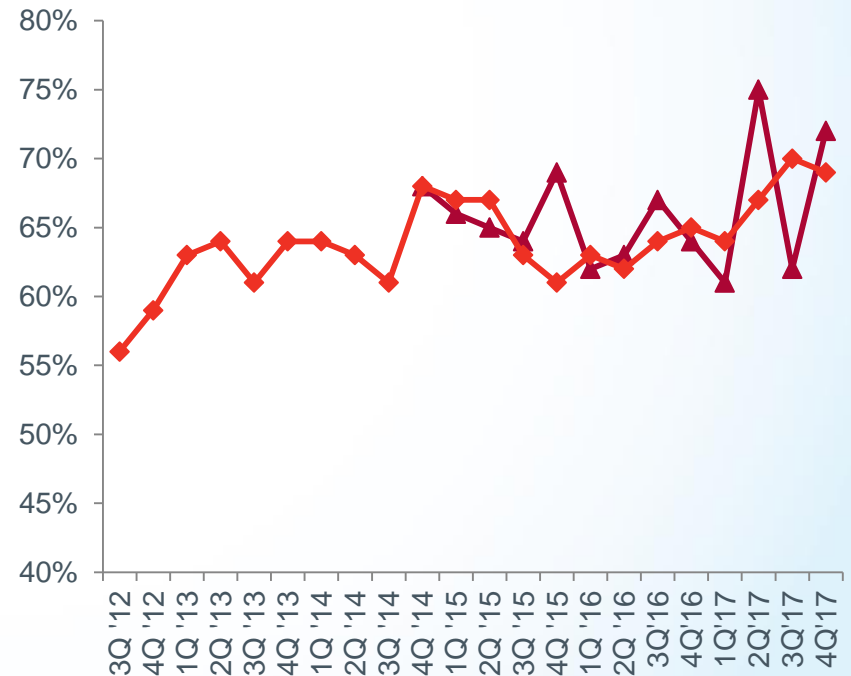
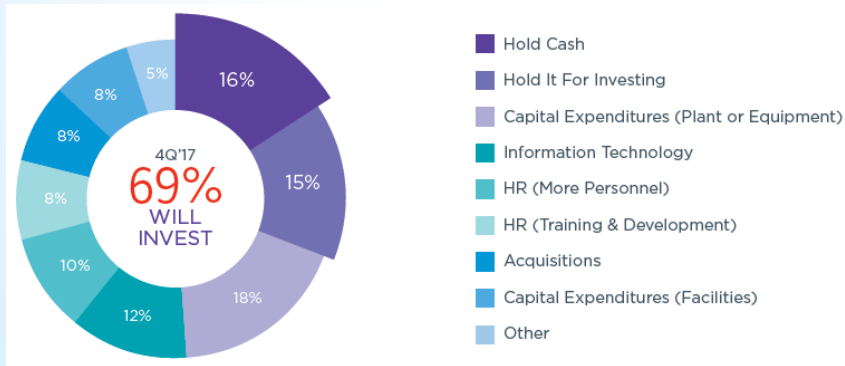
LOCAL ECONOMY

88%

91% PE-OWNED

Q4'17 MIDDLE MARKET INDICATOR CAPITAL INVESTMENT PLANS

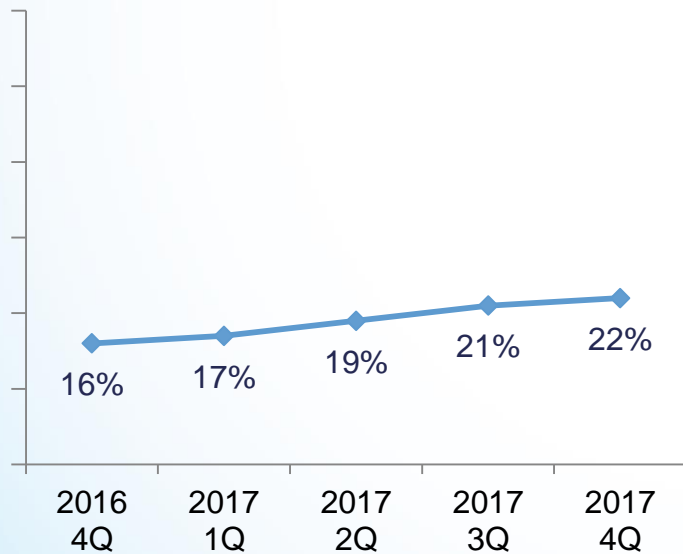
WHAT WOULD YOU DO WITH AN EXTRA DOLLAR OF REVENUE?



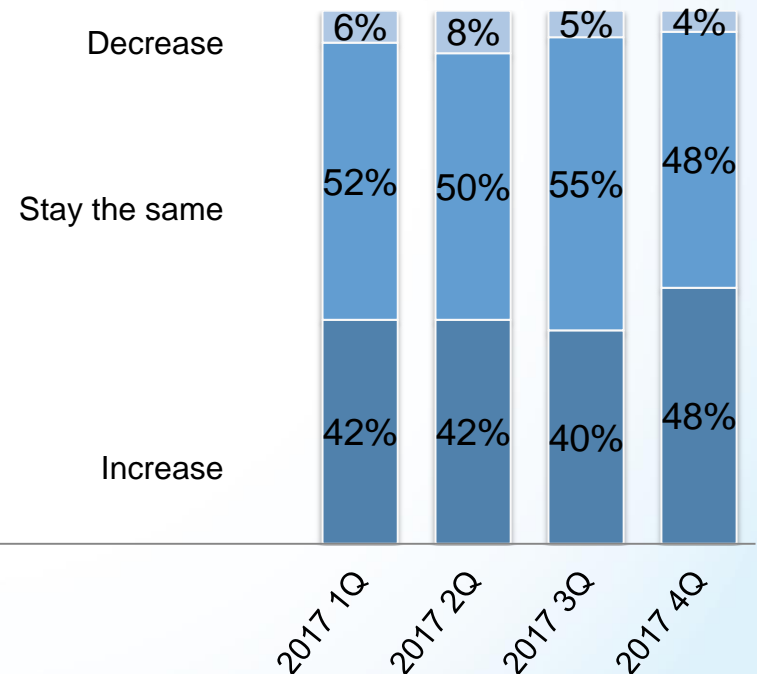
▲ PE-OWNED ◆ U.S. MIDDLE MARKET

COSTS AND PRICES MAY BE BEGINNING TO STIR ...

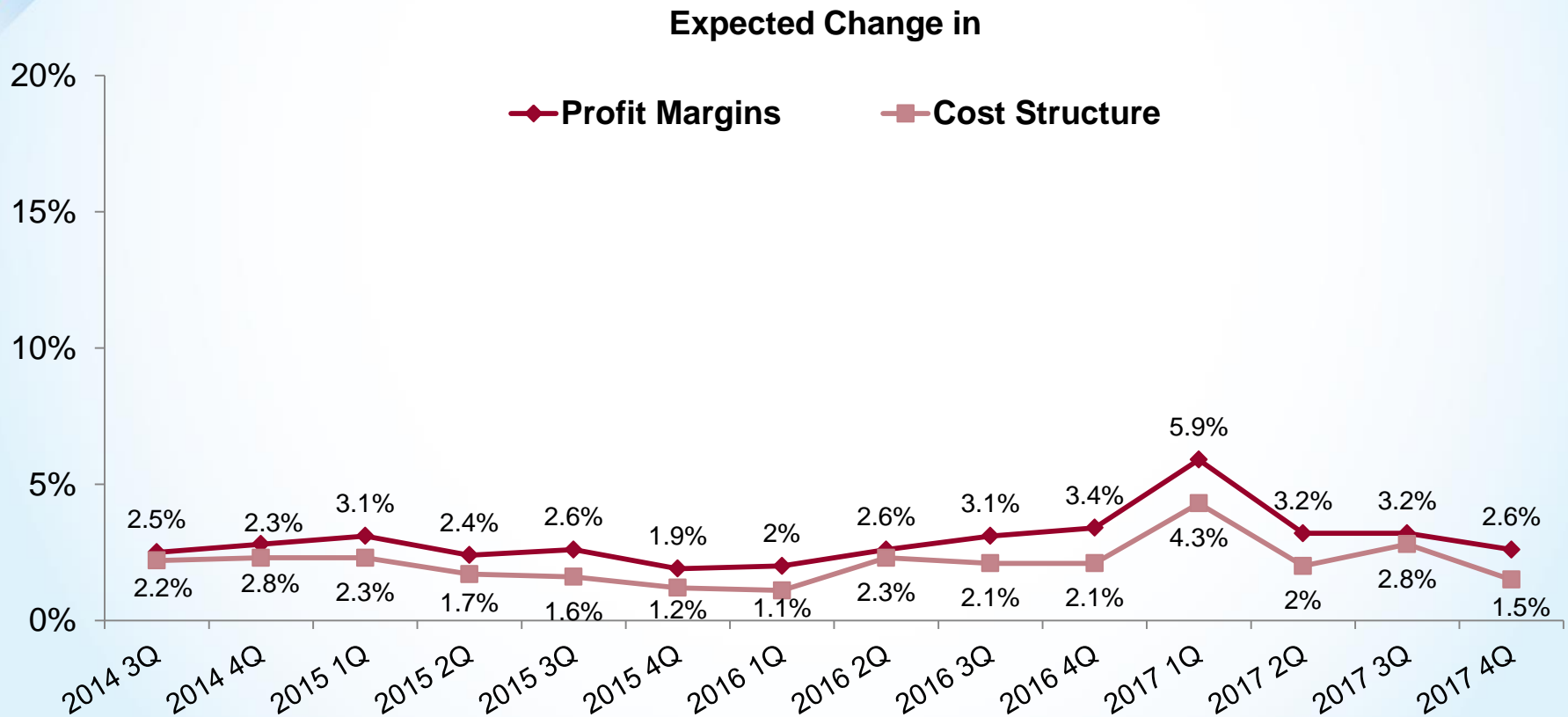
EXECUTIVES CITING A COST ISSUE AMONG TOP THREE INTERNAL CHALLENGES



PRICE ACTIONS EXECUTIVES EXPECT TO TAKE THIS YEAR

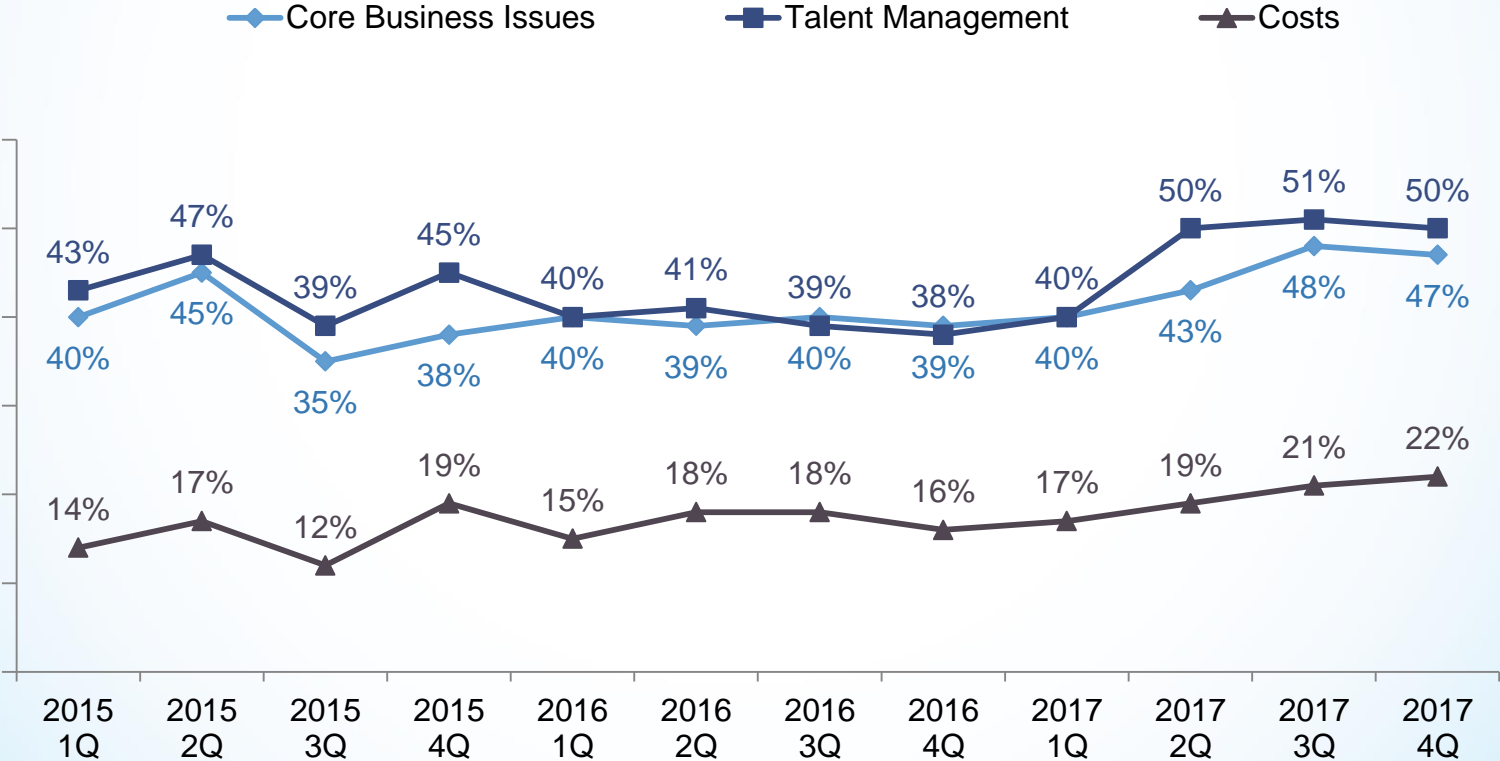


... BUT COMPANIES FEEL COSTS ARE UNDER CONTROL AND MARGINS SAFE



LONG TERM CHALLENGES

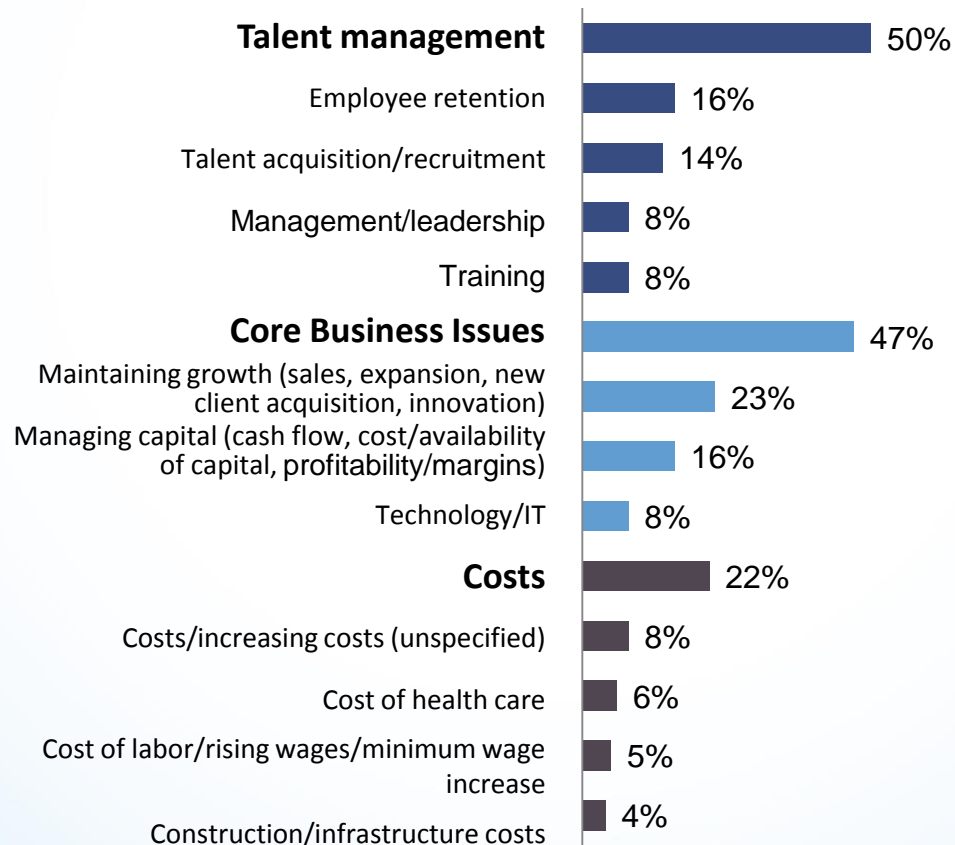
Talent retention and recruitment remain challenging at MM firms as the labor market continues to tighten.



LONG TERM CHALLENGES

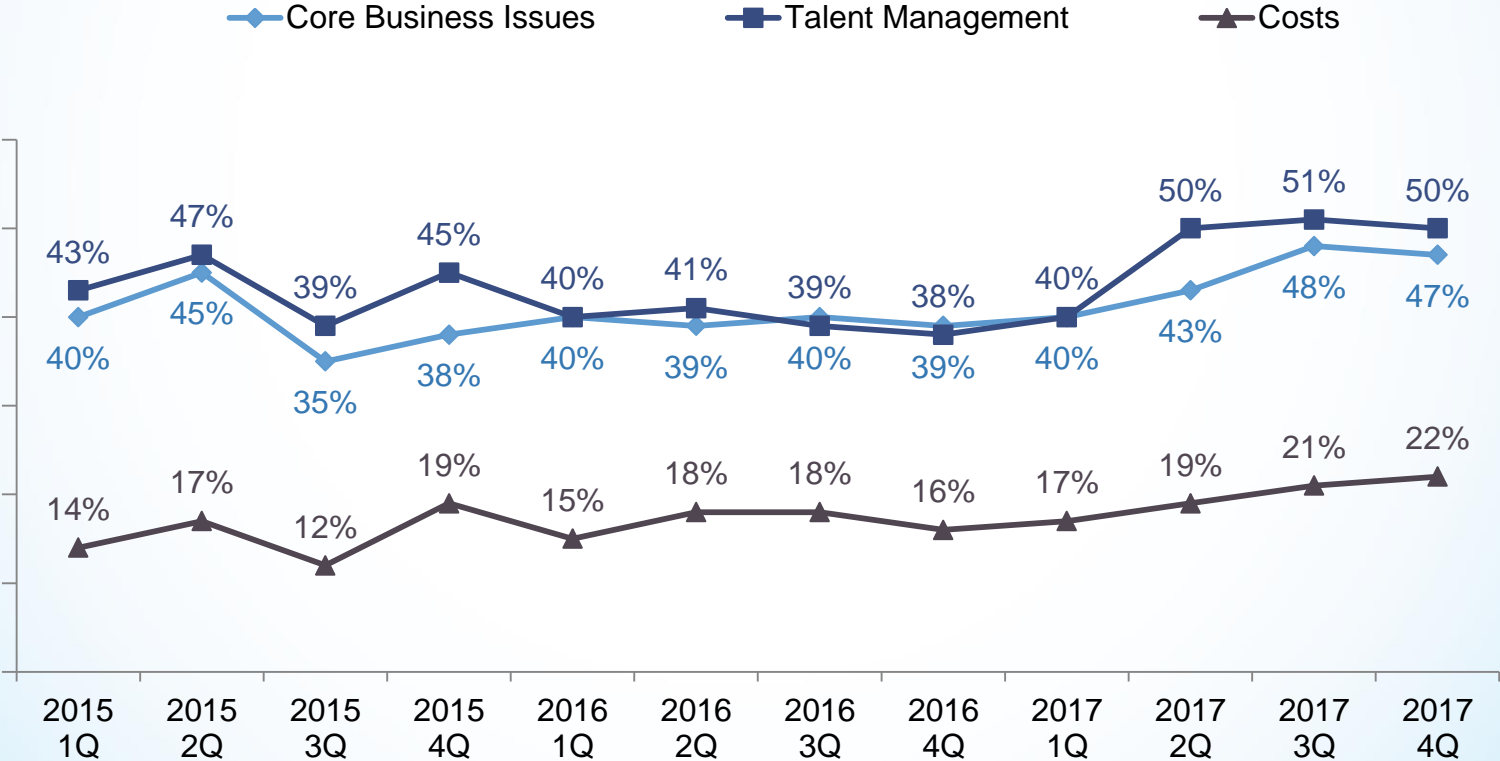
Talent retention and recruitment remain challenging at MM firms as the labor market continues to tighten.

Long Term Internal Challenges

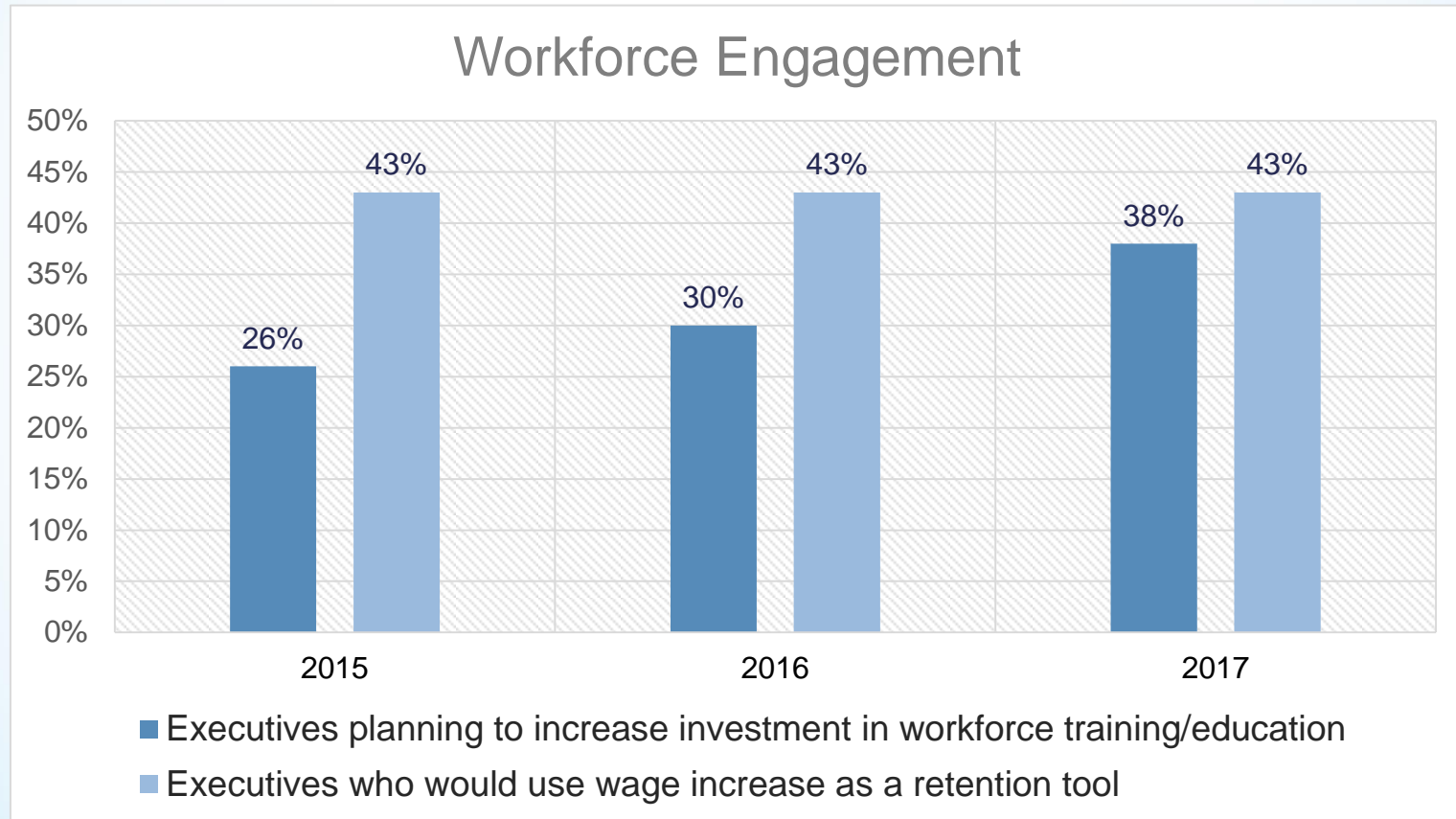


LONG TERM CHALLENGES

Talent retention and recruitment remain challenging at MM firms as the labor market continues to tighten.



GIVEN THE TIGHT LABOR MARKET, COMPANIES ARE BECOMING MORE ENGAGED IN WORKFORCE DEVELOPMENT



FIVE STEPS COMPANIES CAN TAKE ON THEIR OWN

Recruiting: Have an ongoing process (59% recruit only when they have an opening)

Partner: Use educational and training organizations to upskill employees and find new ones (just 30% do)

Internships: Fewer than half of manufacturers offer, vs. 65% in healthcare

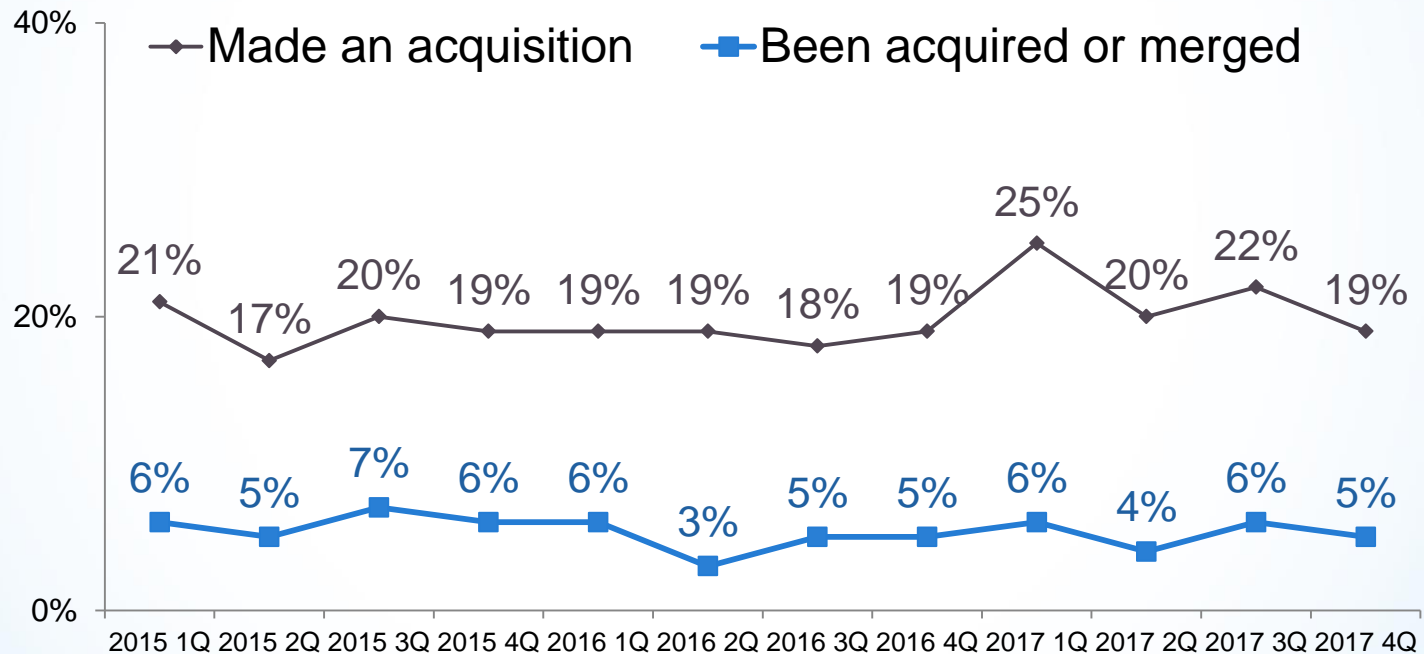
Career pathing, mentoring: Set a process for advancement (only 39% do)

Only 35% of vacancies are filled from within

Training: Build it into daily routines and work (45% train “only when needed”)

MERGERS AND ACQUISITIONS

THERE IS A STRONG, STEADY DRUMBEAT OF MIDDLE MARKET M&A



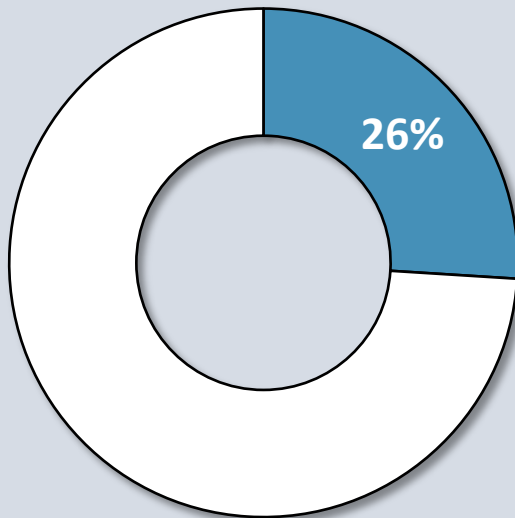
LARGE COMPANIES ARE MOST ACTIVE

In the last three years ...	Total	\$10M- <\$50M Rev	\$50M- <\$100M Rev	\$100M- <\$1B Rev
Completed the acquisition of another business	32%	22%	36%	41%
Acquired a division or line of business from another company	24	16	26	33
Divested or sold a division or line of business to another company	18	13	19	22
Completed a merger with another firm	17	12	21	20

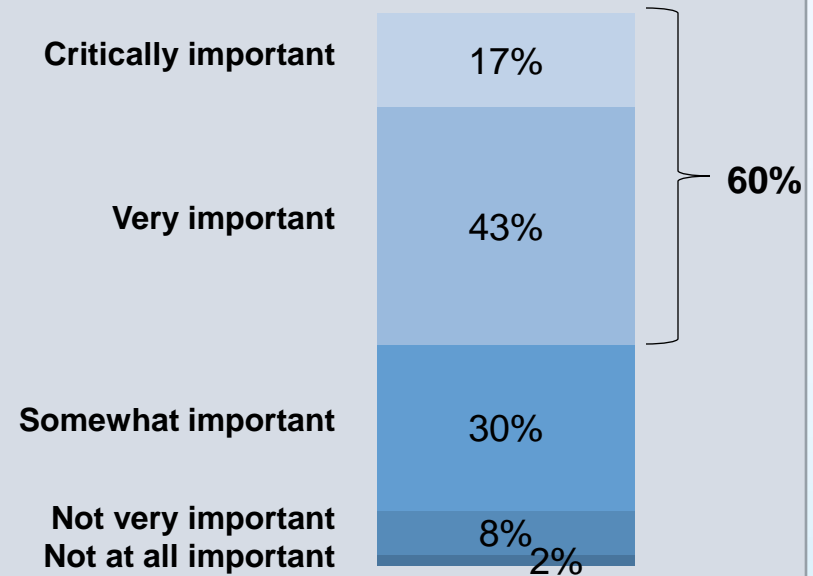
M&A IS HIGHLY IMPORTANT FOR COMPANIES THAT ENGAGE IN IT

AMONG COMPANIES THAT MADE A DEAL IN THE LAST THREE YEARS

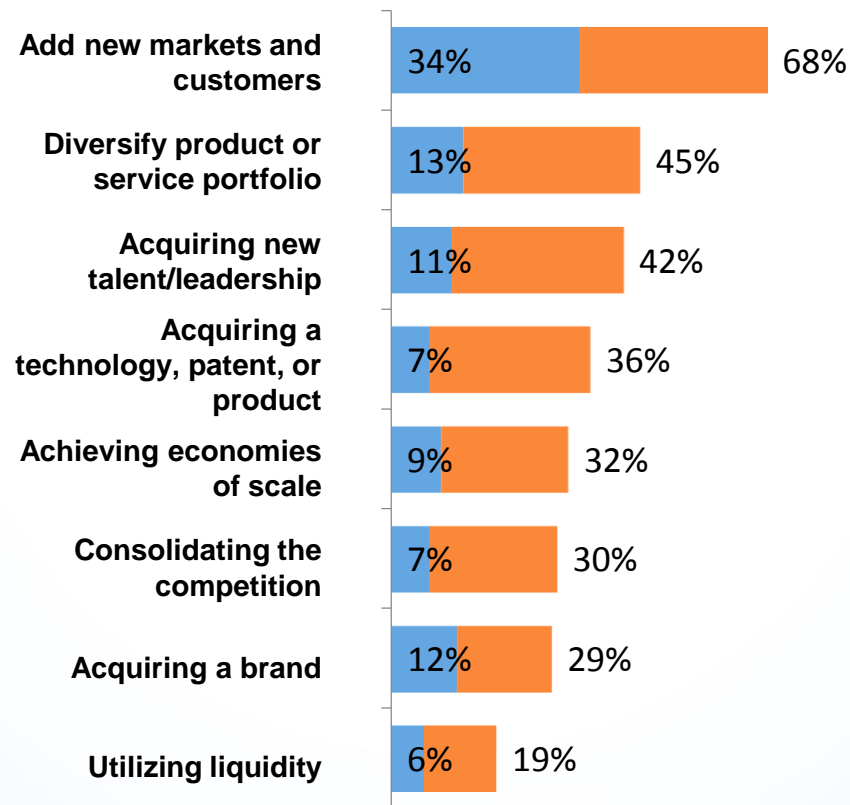
Proportion of Growth Company Hopes to Achieve Through Inorganic Growth



Role of M&A in Growth Strategy



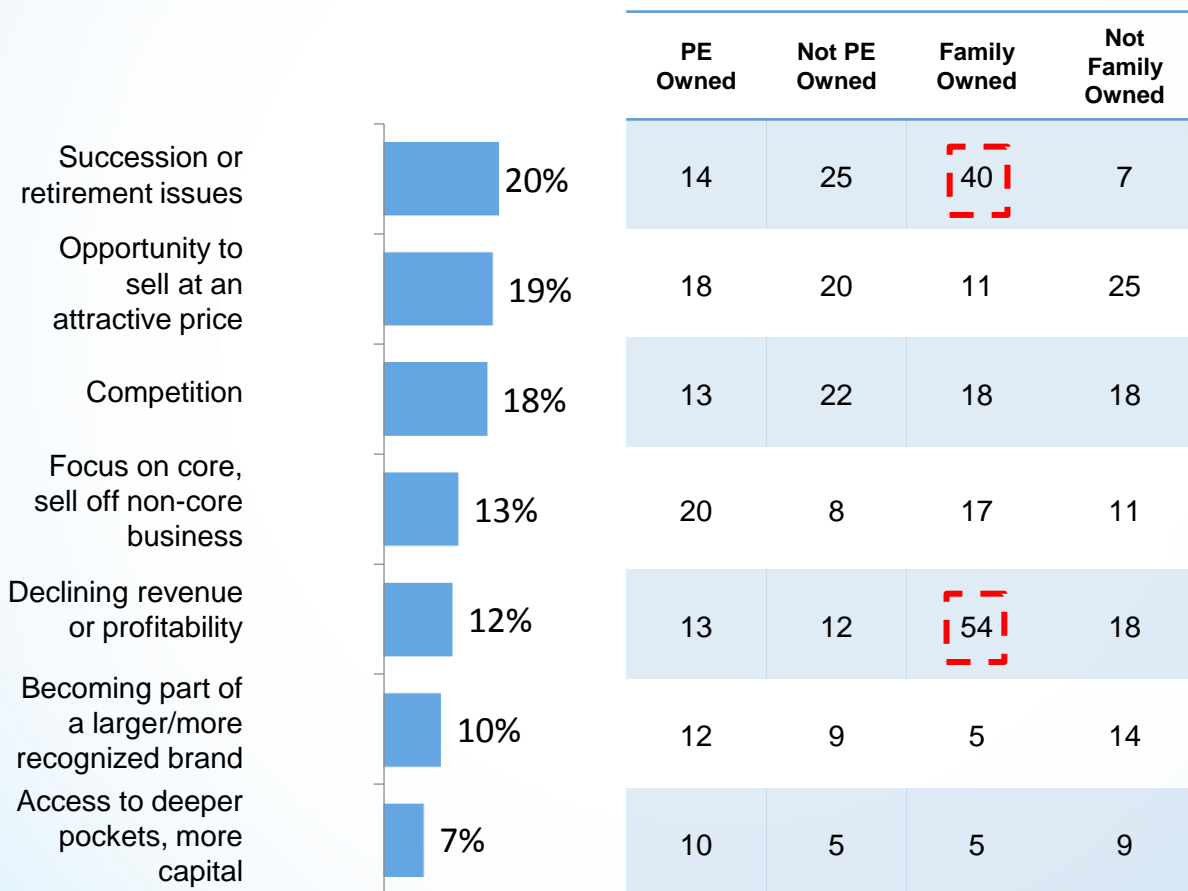
BUYERS' MOTIVES EMPHASIZE GROWTH OVER EFFICIENCY



■ Ranked 1st ■ Ranked 1st/2nd/3rd

SELLERS WANT A PRICE, BUT TRANSITIONS ARE A DEEPER MOTIVE

Important When Deciding to Merge or Sell
(Ranked 1st)



DESPITE M&A'S PREVALENCE, MOST EXECUTIVES ARE INEXPERIENCED

Buyers

First acquisition: 29%

Made other buys but
M&A is not integral to
strategy: 41%

Made other buys and
M&A is integral to
strategy: 30%

Sellers

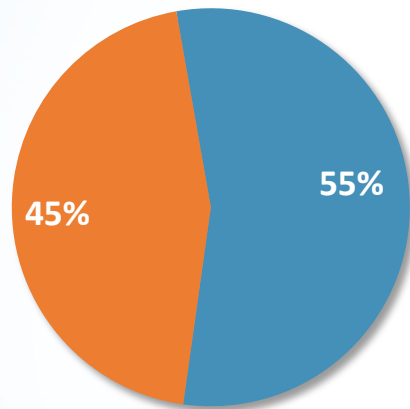
First sale: 46%

Sold parts of business
before but it is not integral
to strategy: 44%

Sold parts of business
before and it is integral to
strategy: 10%

OFTEN, DEALS COME AS A SURPRISE TO SELLERS—AND EVEN TO BUYERS

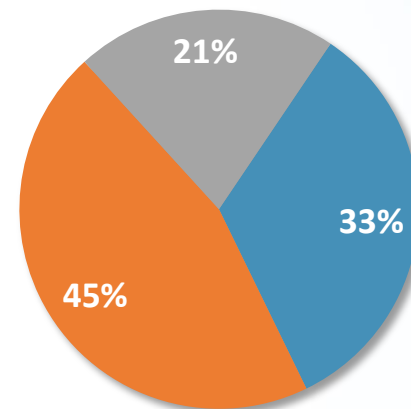
Sellers



We decided to sell, then searched for buyers

We were not planning to sell, but an opportunity presented itself

Buyers



We made a strategic decision, then started searching for a target

We are always looking for opportunities and this one came along

We were not planning to buy, but an opportunity presented itself

CASH IS KING AND SIMPLE IS BEST, UNLESS P.E. IS INVOLVED

	Total Middle Market	Private Equity Involved in Transaction	No Private Equity
<u>Structure of Deal</u>			
Structured transaction such as Earn outs	35	41	33
All equity	27	36	21
All cash	33	20	41
Other	5	4	6
<u>How Was Deal Financed</u>			
Equity (e.g. selling company shares, issuing more stock on public markets)	24	63	0
Cash on hand	48	37	51
Private equity	30	34	29
Bank loan	31	29	33
Sold off assets or another company unit to finance deal	11	15	9
Other mezzanine financing	9	9	10
Other (non-bank) loan	6	5	7
Other means of financing	1	0	2

GOOD TWIN / BAD TWIN : THE PROS AND CONS OF PRIVATE EQUITY



Independence; ability to have decisions made and acted on quickly

Our private equity partners chomp at the bit to loan resources to us

Detailed financial management

Private equity can provide large amounts of funding and has active involvement in company directions.

Easy to deal with management



Key decisions are delayed or deferred

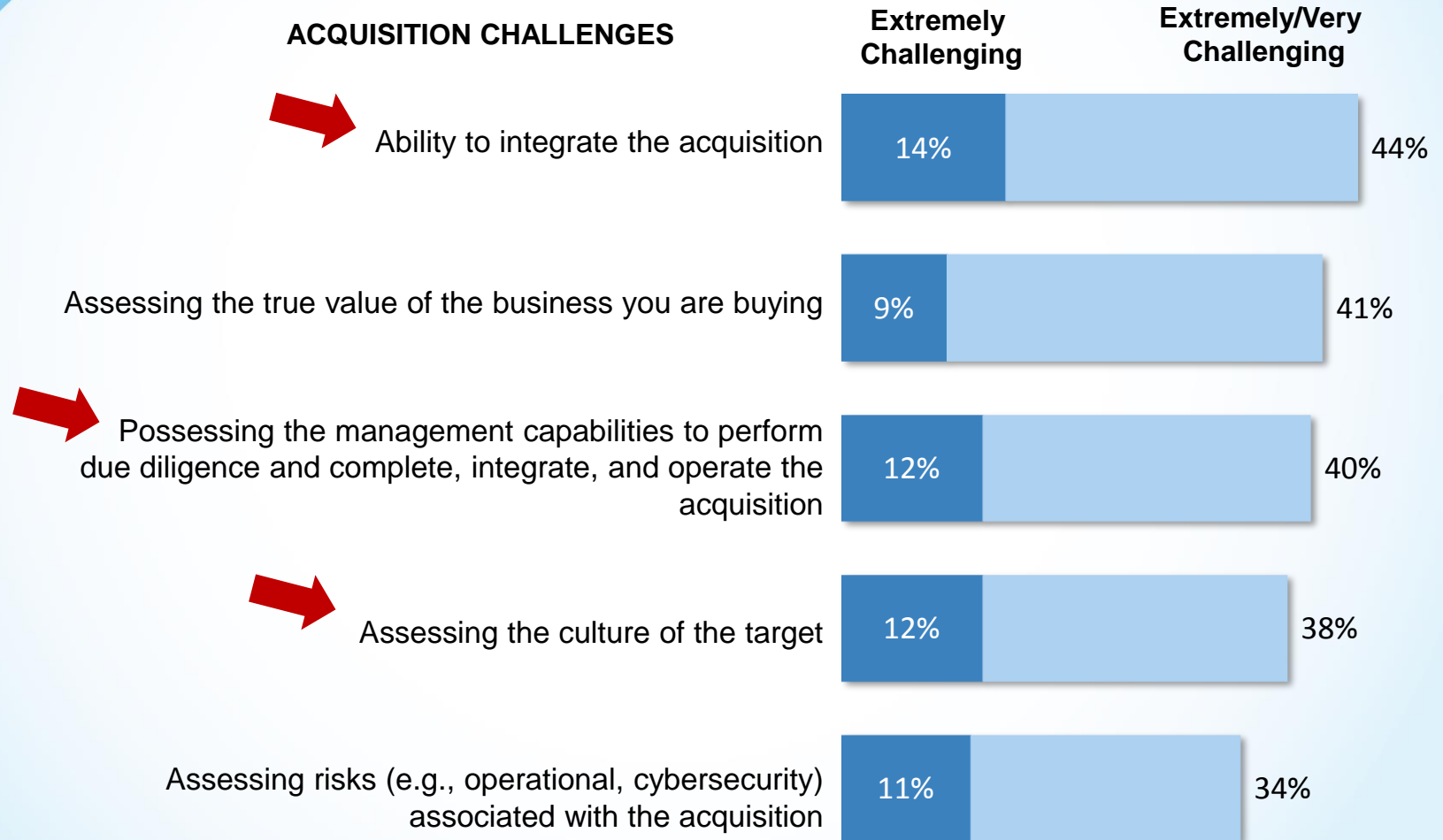
We don't always have as many resources at our disposal

Too much interruption from parent company

Too much time spent answering silly questions, making projections that are unrealistic, and managing cash and debt because company is over- leveraged.

Equity wants to manage and not allow professional management to do their job

“FIT” MATTERS: MANAGEMENT POSES TOUGHEST BUYER CHALLENGES ...



BUT STRATEGY IS THE MOST CONFUSING PART OF DEAL MAKING

MOST CONFUSING ASPECT



A GOOD PRACTICE: BECOME DEAL-READY EVEN WHEN NO DEAL IS AT HAND

A NINE-POINT PROGRAM FOR DEAL READINESS

GOVERNANCE

Clarify and decision rights and operating authority

TALENT

Have succession / retention plans for key positions and players

ACCOUNTING

Keep your books in shape

PLANNING

Create plans, budgets, and KPIs

OPERATIONS

Document processes and set improvement plans

WORKING CAPITAL

Improve management of A/P, inventory, and A/R

TECHNOLOGY

Upgrade systems and maintain an up-to-date cybersecurity plan

ADVISORS

Build relationships with lawyers, bankers, tax advisors, consultants, and others with M&A experience

PEERS

Deepen and broaden connections in your industry



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