

Each quarter, to understand what impact current macroeconomic conditions and government policies have on the business environment, KeyBank surveys 400 owners and executives of middle market businesses – defined as those in the \$10 million to \$2 billion range.¹

Middle market companies leading the way to remain operational despite COVID-19

More than six months since the pandemic arrived in the U.S., communities and businesses are still learning how to live and work safely, even as the threat of the virus still casts a shadow over the U.S. economy. At this pivotal juncture, middle market companies have led the way, pivoting rapidly to remain operational despite COVID-19. Middle market company leaders now feel the impact of the pandemic on their businesses has been the same or better than expected. That viewpoint can in part be attributed to smart actions taken early in the pandemic to help their business respond to and surpass the initial disruption.

Based on the survey conducted in September 2020, the sentiment in the middle market shows stability and continued cautious optimism, however it is tempered by uncertainty about the economy and sociopolitical landscape.

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“When the pandemic began, our clients felt like they were driving a car through the fog; they had a difficult time making projections without any insight into their customers’ plans or the duration and severity of the pandemic. Now they’ve grown better at managing through the pandemic and are prepared to do so longer term, so there’s greater optimism and more clarity to see through the windshield for the next few months.”

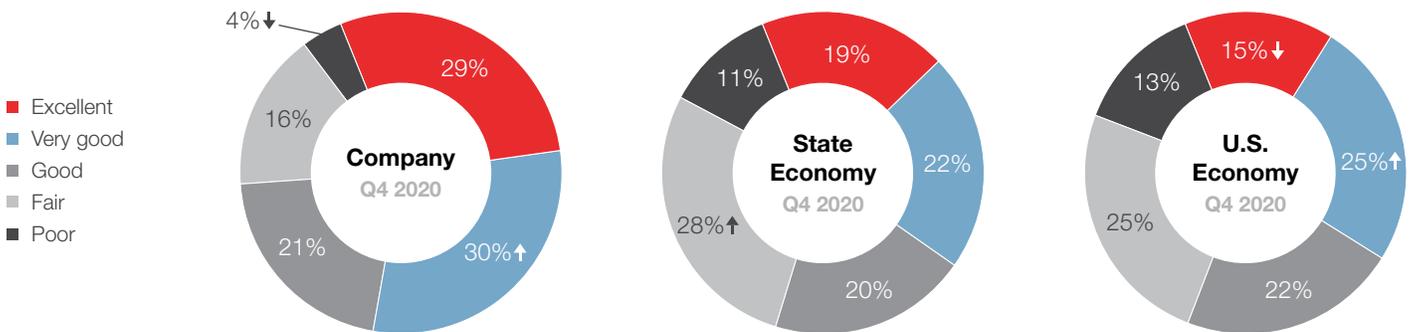
– Skip Watson, Executive Vice President,
Great Lakes Regional Sales Executive, KeyBank

¹Business Owners/Executives – This sample group represents the opinions of respondents who are specifically business owners, C-suite professionals, or have the title of SVP, VP, controller or treasurer (\$10M to under \$2B revenues).

Business owners feel more positive about their own outlook than the outlook for the broader market

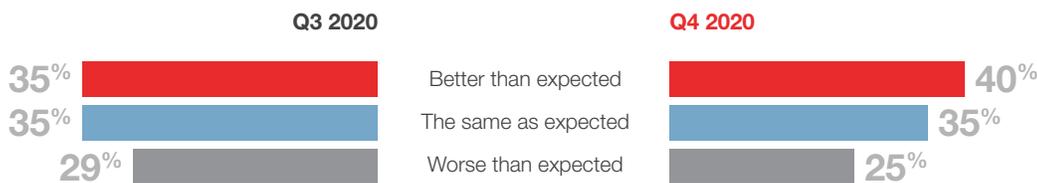
Middle market business leaders are more concerned for others than they are for themselves. In June 2020, middle market business owners' opinions about their company, state, and the national outlook had begun to shift positively as compared to the concerns expressed at the start of the pandemic. Since June, their outlook at the national level has become a bit more pessimistic, with fewer companies indicating an "excellent" outlook. State outlook is also slightly more pessimistic than before, while company outlooks remain much more optimistic and have seen a slight uptick since June. In total 59% of respondents said their own company outlook was excellent or very good, and another 21% said it was good.

Overall Outlook for the Next 12 Months



Similarly, perceptions about the overall health of their business amid COVID-19 have remained flat since business executives were last surveyed in June. More than half of respondents (52%) say they are very or somewhat positive about the health of their business. The positivity can likely be attributed to the fact that most middle market businesses continue to feel that the impact of COVID-19 on their business has been the same or better than their original expectations. In fact, respondents who say it has been better than expected have grown from 35% in June to 40% now. It's germane to say that those expectations might have been low, given the lack of visibility into the future anyone had in the first few months of the pandemic.

COVID-19 Business Expectations



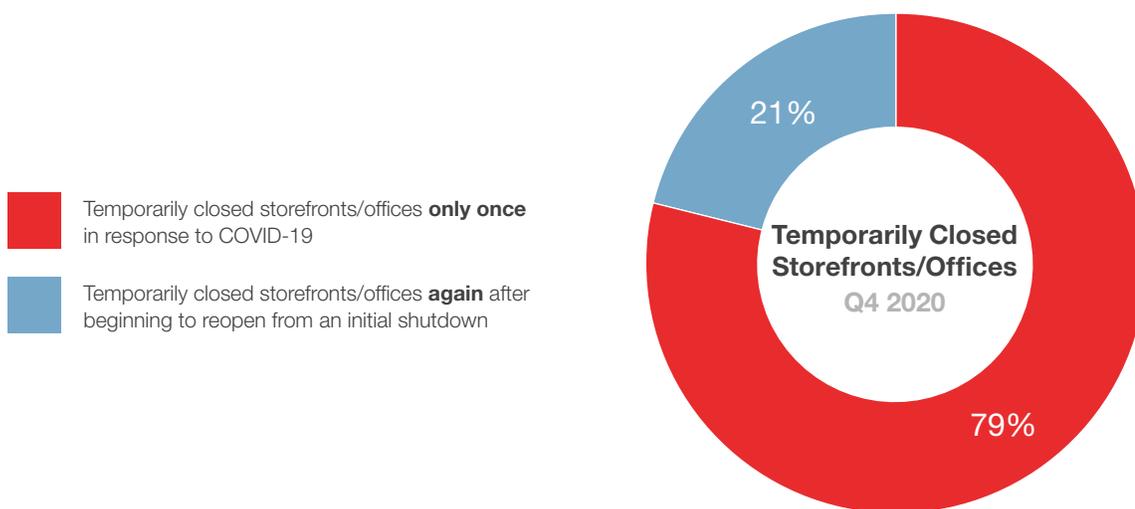
Why do leaders have more concerns about the nation than about their business? It could be because they acted swiftly and decisively against the virus within their organizations. The majority of middle market businesses report changing their operations somewhat or very much in response to COVID-19. These actions included: taking additional safety measures (85%), seeking out loans or additional sources of credit (52%), and reducing staff or compensation (49%).

"The Paycheck Protection Program was a nice buoyancy device that most companies used as it was intended: to keep people employed and cover expenses," said Joseph Markey, East Regional Sales Executive, KeyBank.

However, Markey points out that while businesses that received funding in first round of the federal stimulus may be on solid footing now, other companies that **didn't get access to funds in the first round**² or are in harder hit industries such as travel, retail or entertainment, may need more stimulus assistance to survive.

One good sign is that most middle market businesses are in the process of getting back to normal operations since the initial shutdowns. As of September 2020, more than half of middle market business owners say they are somewhat or fully back to normal operations and only 2 out of 10 report having to close more than once due to the pandemic.

Multiple Business Closures Due to COVID-19



COVID, recession fears, and political uncertainty impeding outlook

For those who have a poor, fair or good outlook of the U.S. economy, it's no surprise concerns with COVID-19 continue to be the overwhelming reason for their sedate outlook. Concern with a potential economic recession has decreased from 67% to 58% since June but remains among the top concerns. Unsurprisingly, the volatile political landscape rounds out the top three reasons for a low outlook.

Markey observes that in the Eastern Region of the Country, which was one of the earliest and hardest hit areas of the United States, concerns about a **potential second wave of coronavirus** cases have dampened some companies' plans or caused them to make more conservative projections.³

Slightly more business owners are anticipating a somewhat or very negative impact on their business due to political uncertainty – 35% versus 32% in December 2019 – but fewer are expecting to make changes as a result. Both Watson and Markey say clients are holding off on making aggressive moves until the political picture stabilizes. Meanwhile, contentious negotiations over a **second stimulus bill** are adding to the economic and political instability.⁴

²Vox, "The Paycheck Protection Program failed many Black-owned businesses." October 5, 2020 <https://www.vox.com/2020/10/5/21427881/paycheck-protection-program-black-owned-businesses>

³Washington Post, "Experts project autumn surge in coronavirus cases, with a peak after Election Day." September 5, 2020 https://www.washingtonpost.com/health/coronavirus-fall-projections-second-wave/2020/09/04/6edb3392-ed61-11ea-99a1-71343d03bc29_story.html

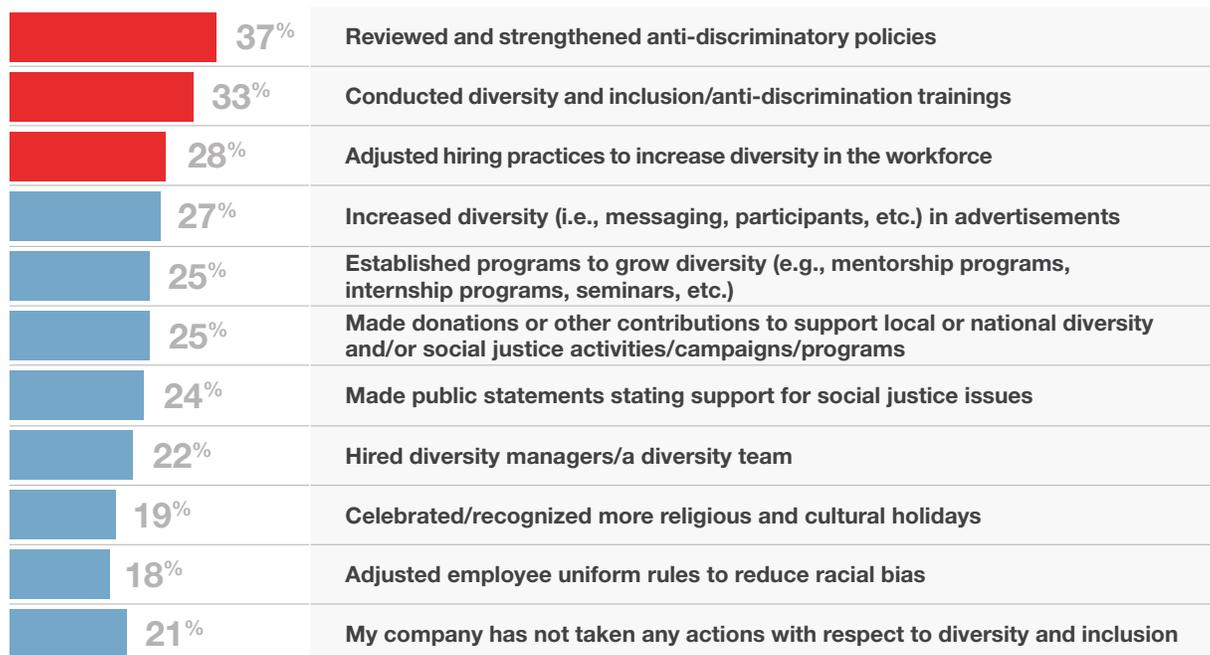
⁴New York Times, "Anxious for a Lifeline, the U.S. Economy Is Left to Sink or Swim" October 7, 2020 <https://www.nytimes.com/2020/10/07/business/second-stimulus-bill-fails-impact.html>

Companies focus on diversity and inclusion efforts in response to civil action

COVID-19, however, is not the only game changer of 2020. As the country has confronted a generational public health crisis, it is also dealing with an **eruption of social activism and civil unrest** over systemic racial injustices.⁵ In response, most U.S. companies have placed a renewed focus on efforts to address bias in their own operations. While a majority of middle market businesses claim diversity and inclusion is very or extremely important to their company, their actions or planned actions are varied. Over the past 12 months, the most common actions have been strengthening anti-discriminatory policies (37%) and conducting diversity and inclusion trainings (33%).

Diversity Actions Business Has Taken in Past 12 Months

Q4 2020



Middle market M&A not back to earlier expectations

The state of the current economy has also extended to the merger and acquisition (M&A) marketplace for middle market firms. Fewer businesses have completed an acquisition in the past six months: 27% versus 35% in June. The overall likelihood of a middle market company completing an acquisition is also slightly down compared to earlier in the year. The majority of respondents (55%) say that the COVID-19 pandemic has somewhat or significantly impacted valuations, which may be what is dampening activity. However, Key's regional sales executives are seeing some signs that M&A will pick up.

"Most of the activity has been with financial-sponsored groups, rather than strategic buyers, and they are picking up deals that may have been paused when the pandemic first hit," said Markey. "We're also seeing an interesting increase in business owners exploring ESOP (employee stock ownership plan) structures rather than selling to financial sponsors. It points to a more altruistic view of the company and employees."

⁵ USA Today, "In 2020, unprecedented protests have swept through Louisville and the U.S. Why now?" September 19, 2020. <https://www.usatoday.com/story/news/nation/2020/09/19/why-louisville-nation-has-been-rocked-with-protests-in-2020/3484320001/>

Continued progress as the year draws to a close: hoping for the best in 2021

Middle market leaders have never experienced a year like 2020. The year began with a positive outlook and expectations of growth and strong activity even amid recession concerns and political volatility. Then the extraordinary disruption of the COVID-19 pandemic took hold. The good news is many middle market firms pivoted rapidly then managed well through crisis; as a result, they are now feeling tempered positivity even though the pandemic is far from over.

KeyBank is committed to providing real-time support and market insights as businesses continue to respond to the COVID-19 crisis, sociopolitical uncertainty and their impact on the economy. Our Relationship Managers can bring your company value-added strategic advice and solutions to help navigate a volatile market.

We're here for you.

For more information on KeyBank's middle market capabilities, contact a KeyBank Relationship Manager.



"KeyBank Middle Market Business Sentiment Survey" September 2020.

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