

**Get the straight story:
Survey of U.S. manufacturing executives.**

Comprehensive Report
July 2009



Candor. Insight. Results.

Preface

Timothy L. Christen
Chief Executive Officer

I would like to thank the 300 senior executives of U.S. manufacturing companies who participated in Baker Tilly's survey of the manufacturing industry.

This report highlights responses from a cross-section of industry participants regarding the economy, U.S. Cap and Trade program, international plans, and IFRS accounting standards. Consider the following key findings:

- > Senior manufacturing executives are cautiously optimistic about the economy in the next six months, but are more likely to be pessimistic about their own sector.
- > This downturn in the economy is toughest on small manufacturers, with a sizable minority struggling to make it through. Executives from larger companies are more likely to report they are using tools such as tax planning and negotiating vendor discounts. Larger businesses are also more likely to use foreign markets to diversify their revenue sources.
- > U.S. manufacturers remain focused primarily on serving domestic markets.
- > Most senior manufacturing executives are not aware of the potential adoption in the U.S. of the International Financial Reporting Standards, or IFRS.
- > U.S. manufacturing executives oppose Cap and Trade proposals, though a sizable minority is somewhat supportive of the legislation. Support draws closer to even if Cap and Trade were instituted multilaterally and would not leave manufacturers without unregulated foreign competitors.

Survey respondents:
300 senior executives
of small, medium, and
large U.S. manufacturing
companies.

Challenging economic times require a new approach to doing business. This report sheds light on the perspectives and insights of manufacturers who must deal with the reality of the economy and prepare for an unpredictable future.

Executive Summary

Economic outlook

Cautiously optimistic: Nearly six in ten manufacturing executives (57%) have a positive outlook for the U.S. economy over the next six months, but slightly (51%) more than half are pessimistic about the outlook for the manufacturing sector.

Right-sizing – Holding the line on staffing: Over the next six months, 70% of the manufacturers surveyed said they plan to keep staffing levels the same.

Brighter days ahead for some: About half of executives (49%) surveyed expect their firm's performance to decline, with 12% saying their firm is in danger of failing. Executives from small firms (14%) were much more likely to report danger of failing than those from medium (2%) or large firms (3%).

Key growth obstacle: Over the next twelve months, the top challenge for U.S. manufacturers is raising demand for their products.

Economic survival strategies: Over the next twelve months, the majority of manufacturing executives expect to reduce operational (80%), supplier (65%) and labor (51%) costs. They also plan to look for tax advantages (66%) and increase the diversity of product or customer base (65%).

Staying the course? Despite pressure to reduce costs, executives said they are continuing to invest in their companies. The most common investments are in quality improvement systems (51%).

Still hunting for bargains: Among executives with plans for M&A activity, most (85%) report no change in their plans, 12% plan to increase, and 3% plan to decrease it.

Cap-and-trade

Moderate familiarity: Half of manufacturing executives, more so among executives from large companies, are at least somewhat familiar with cap-and-trade legislation. Executives from medium and large companies are more familiar with the legislation than small companies (62% vs. 49%).

Strong opposition, but soft support: Nearly six in ten manufacturing executives (59%) oppose a cap-and-trade program. Opposition increases the more familiar executives are with cap-and-trade. Legislative support increases among executives who are optimistic about the outlook for the U.S. economy and manufacturing sector, and invest in green programs.

A competitive handicap: Slightly more than four in ten (42%) manufacturing executives believe a cap-and-trade system would place them at a competitive disadvantage in the global marketplace.

Overseas adoption equals more support: Four in ten executives (40%) support an international cap-and-trade program as compared with one in three for a U.S. program. More than one fourth (28%) of executives who initially opposed cap-and-trade said overseas adoption would make them more likely to support the legislation.

The impact of rising energy costs: If energy costs increase under a cap-and-trade system, the most common response would be to pass on costs to their customers, followed by delaying new capital investments.

“Many manufacturers see reasons for cautious optimism, but there is a ‘wait and see’ attitude regarding demand.”

International plans

Global revenue snapshot: Nearly half of U.S. manufacturing executives (47%) report their companies have no revenue outside of the country. Among the 52% who engage in overseas commerce, 42% are collecting under 25% of their revenue from foreign markets and 10% are collecting 25% or more.

New customer projections: Among manufacturers that already derive some revenue from outside the U.S., eight in ten executives (80%) said most of their new customers would come from domestic markets over the next three years. A small minority (14%) plan for most of their new customers outside.

Global opportunity markets: Over the next three years, manufacturers that are involved in commerce outside of the U.S. plan to focus most on China (44%) and Mexico (40%).

IFRS Accounting Standards

Low awareness of potential U.S. adoption: More than six in ten executives (62%) are unaware that the U.S. is considering adopting the International Financial Reporting Standards (IFRS). However, executives at large firms were much more likely to be aware (86%) compared to small firms (32%).

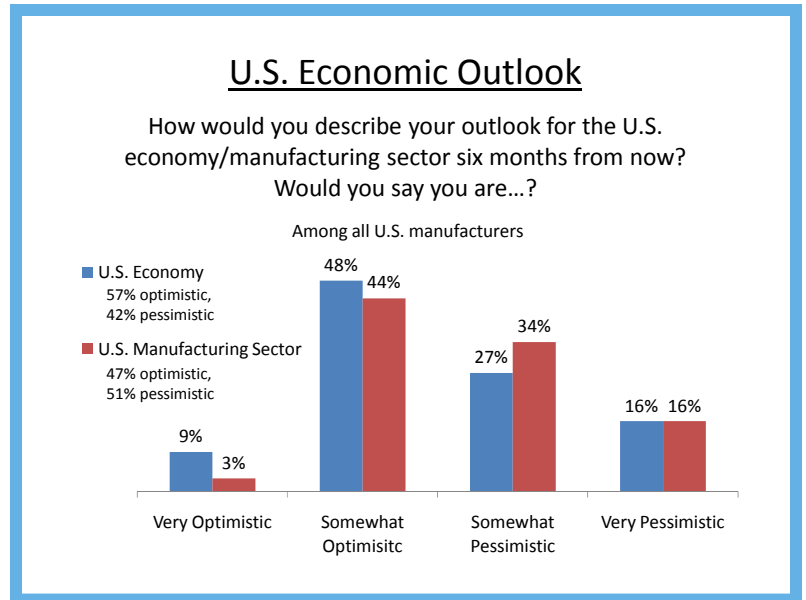
IFRS adoption impact: Only one in four executives believes the adoption of IFRS would have some impact on their reporting process, although four in ten (41%) executives from medium and large firms believe there will be some impact compared with two in ten executives from small businesses (21%).

Detailed findings

The U.S. economy

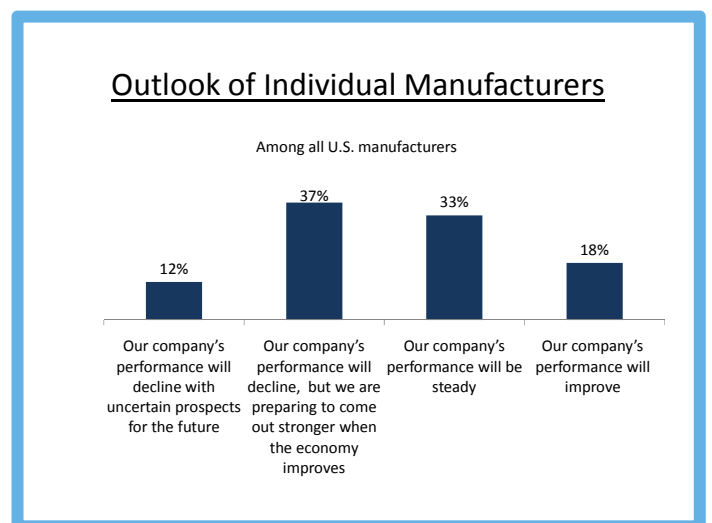
Mixed cautious outlook: The mood is cautious as senior manufacturing executives are slightly more optimistic than pessimistic about the shape of the economy six months from now, and slightly more pessimistic about the manufacturing sector.

- > Nearly six in ten manufacturing executives (57%) have a positive outlook on the U.S. economy six months from now, while 42% have a negative opinion. However, executives are more pessimistic about their own sector, with 47% optimistic about the manufacturing sector six months from now and 51% pessimistic.
- > Executives from small manufacturers are significantly more likely than executives from medium and large companies to have a very pessimistic outlook on both the U.S. economy and the U.S. manufacturing sector over the next six months (18% vs. 4%; 18% vs. 7%).
- > Executives from the Midwest are more likely than those from the South to have a very optimistic outlook (14% vs. 2%, respectively) on the U.S. economy over the next six months, while southern executives are more likely to be very pessimistic with their outlook (22%).



Larger manufacturers weathering the economy: Regarding their own company's situation, half of U.S. manufacturers expect company performance to decline, but only a minority (disproportionally small businesses) is in danger of failing.

- > When reporting on their own company, half said their performance has been steady or improving (51%), while half are declining but plan to recover or are declining and with an uncertain future (49%).
- > One in ten executives (12%) said they expect company performance to decline with an uncertain future. However, executives from small businesses were much more likely to report this (14%) than executives from medium (2%) or large manufacturers (3%). Of the smallest manufacturers, with less than \$1 million in annual revenue, 23% said their future is uncertain.
- > Despite the poor economy, more companies report that their performance is improving (18%) rather than declining to the point of uncertainty (12%).



> Looking ahead to the next six months, seven in ten manufacturing executives expect their company to have no net change in their staff, while 20% plan to have a net reduction and 9% plan a net increase (2:1 decrease to increase).

> Executives who are optimistic about the U.S. economy six months from now are more likely to say their companies will have a net increase than executives who are pessimistic (12% vs. 5%). Moreover, three in ten executives who are pessimistic about the U.S. economy (30%) say their company will have a net staff reduction (compared to 13% among those who are optimistic). In another way to look at this, executives who are optimistic feel they are as likely to have a net gain of staff as they are a net loss (12% vs. 13%) while pessimistic executives are six times less likely to feel they will have a net gain in staff (5% vs. 30%).

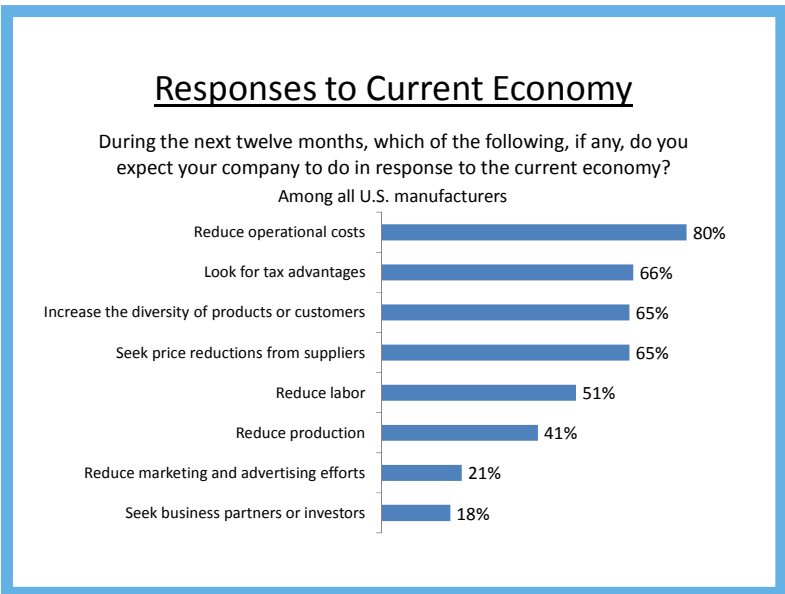
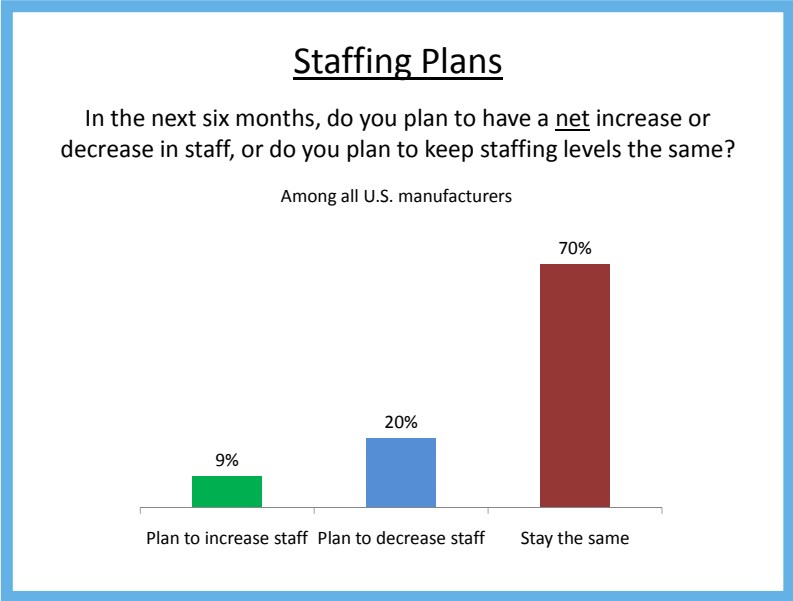
> Among manufacturing executives with plans for mergers and acquisitions, most (85%) report no change in their plans, 12% plan to increase their transaction activity, and 3% plan to decrease it.

> Over the next twelve months, senior manufacturing executives reported plans to do a number of things in response to the current economy.

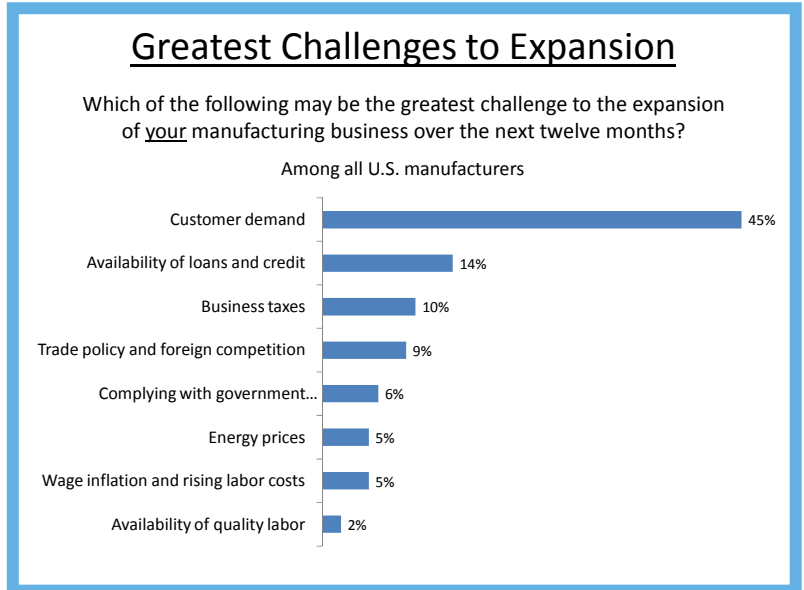
- > Eight in ten executives are looking to reduce operational costs (80%).
 - The likelihood is higher among larger companies to seek these reductions (78% of smaller manufacturers are doing this compared to 91% of medium and large manufacturers).
- > Two in three plan to look for tax advantages (66%).
 - The largest manufacturers, those with annual revenue in excess of \$250 million, are more likely to seek these advantages (83%) than smaller companies (61% where revenue is less than \$1 million a year and 68% where revenue is between \$1 million and \$250 million).

> Two in three expect their company to increase their diversity of products or customers (65%).

- > Two in three (65%) will seek a reduction in costs from their suppliers.
 - Larger companies are more likely to look for price reductions from suppliers.
 - Manufacturers with < \$1 million in annual revenue: 55%
 - Manufacturers with \$1 to \$25 million in annual revenue: 66%
 - Manufacturers with \$25 to \$250 million in annual revenue: 76%
 - Manufacturers with \$250 million and more in annual revenue: 94%

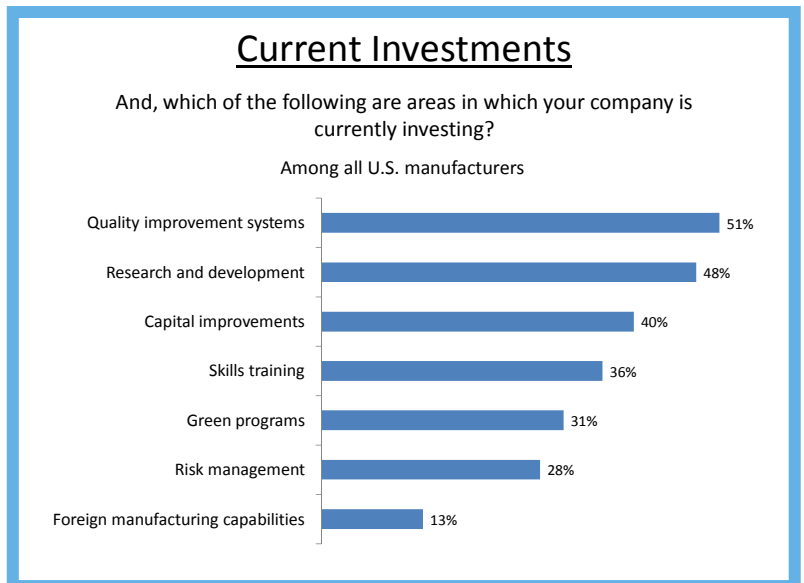


- > Half plan to reduce labor (51%).
- > Two in five expect they will need to reduce production (41%).
- > One in five plan to reduce marketing and advertising (21%).
- > One in five expects to seek a business partner or investors (18%).
- > In today's economy, the top challenge for U.S. manufacturers is raising demand for their products. From a list of eight possible challenges, nearly half of senior manufacturing executives (45%) said customer demand is their greatest challenge to building their business.
 - > More than one in ten (14%) said their company's biggest challenge is availability of loans and credit. Another one in ten cited business taxes (10%) as the greatest challenge for expansion.
 - Small companies are significantly more likely than medium and large businesses to perceive business taxes as a greatest challenge (11% vs. 5%)
 - > Other problems selected as a greatest challenge included trade policy and foreign competition (9%), complying with government regulations (6%), energy prices (5%) and rising labor costs (5%).
 - Medium and large companies are significantly more likely than small companies to view energy prices as the greatest challenge over the next twelve months (13% vs. 4%)



Most continue to invest in their businesses: Strong majorities of U.S. manufacturers continue to invest in their companies.

- > From a choice of seven areas, executives from eight in ten manufacturers (81%) report they are investing in at least one area—including 79% of small manufacturers, 94% of medium and 100% of large manufacturers.
 - > The most common investments are in quality improvement systems (51% overall, 47% of small manufacturers, 69% of medium and 82% of large manufacturers) and research and development (48%, 45%, 67% and 79%).
 - > Other things executives report investing in include capital improvements (40%, 36%, 63%, 71%), skills training (36%, 32%, 67%, 63%), green programs (31%, 27%, 49%, 63%) and risk management (28%, 24%, 52%, 57%).



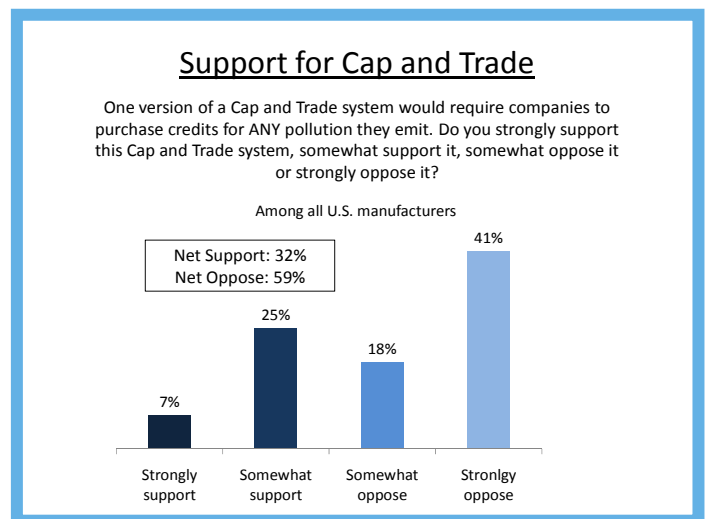
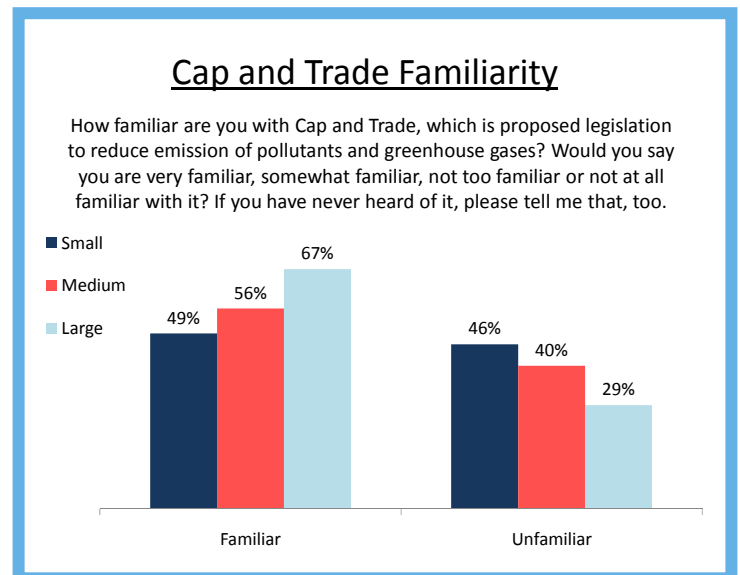
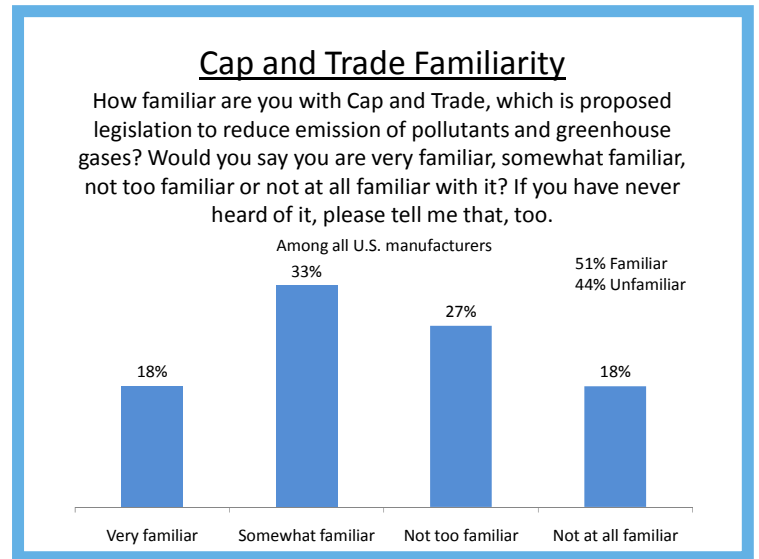
Cap and Trade legislation

Moderate familiarity with key legislation: Half of senior manufacturing executives, more so among executives from large companies, are at least somewhat familiar with Cap and Trade legislation.

- > Given an aided description of Cap and Trade legislation, half of senior manufacturing executives (51%) said they are very or somewhat familiar with the proposal. Nearly half (44%) said they had heard of the legislation but were not familiar with it. Another 5% of senior executives said they had not heard of the legislation.
- > Executives from medium and large companies are significantly more likely than executives from small companies to be at least somewhat familiar with Cap and Trade (62% vs. 49%).

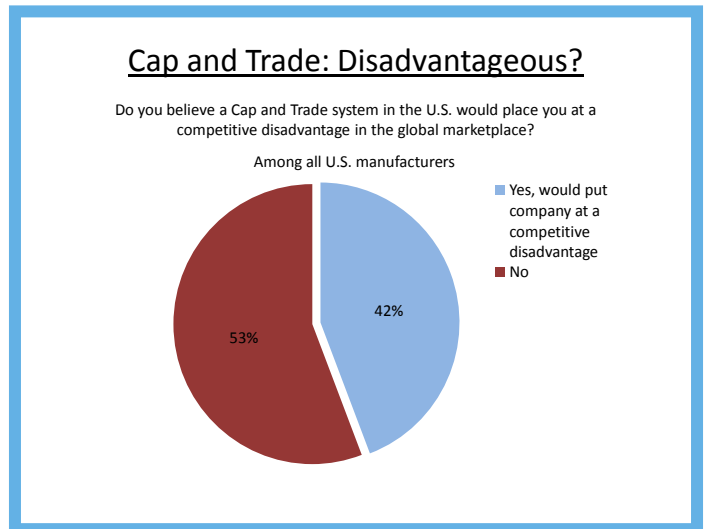
Pockets of support may surprise some: Manufacturing executives are squarely against Cap and Trade legislation, but there is a sizable pocket of soft support.

- > To gauge a baseline understanding of the position of manufacturing executives, we tested support for a Cap and Trade system in which companies would be required to purchase credits for any pollution they emit, which some might consider the most expensive proposition for manufacturers. Under this scenario, one in three senior manufacturing executives (32%) support the legislation—however, this support is fairly *soft* since 7% *strongly* support this and 25% somewhat support it. Nearly six in ten manufacturing executives (59%) oppose this Cap and Trade system, including four in ten executives (41%) who *strongly* oppose it.
- > Opposition increases among executives who are more familiar with the topic. Over half of manufacturing executives (52%) that are at least somewhat familiar with Cap and Trade are strongly opposed to a system in which they would have to buy credits for any pollution they emit.
- > Support increases among executives at manufacturing companies that are investing in green capabilities. Four in ten executives investing in green projects (40%) support this type of Cap and Trade system, compared to only 28% supporting among those not investing in green projects.
- > In addition, support is higher among executives who are optimistic about the economic outlook overall and in the



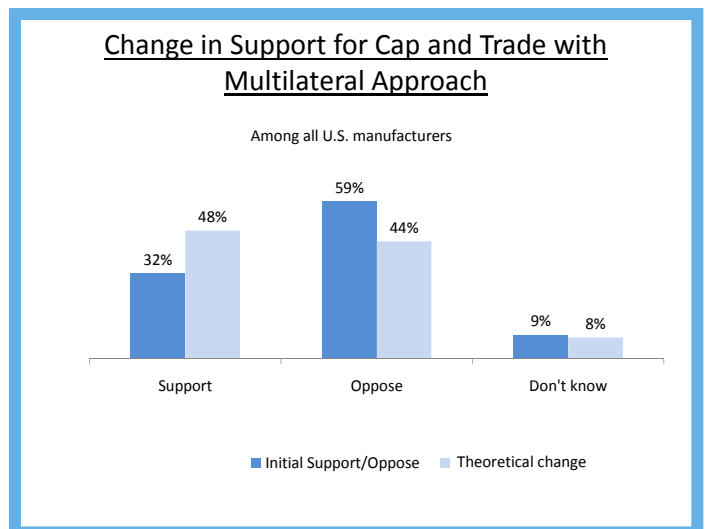
manufacturing sector. Executives who are optimistic about the U.S. economic outlook are more likely to support Cap and Trade (38%) than those who are pessimistic (24% support); 52% of those who are optimistic oppose this Cap and Trade scenario, including 30% who *strongly* oppose – compared to 68% of those who are pessimistic opposing the legislation and 55% *strongly* opposing it.

- > Providing manufacturers with a certain percentage of free pollution credits did not significantly increase support for Cap and Trade (33% support and 58% oppose).
- > Concerns about losing a competitive advantage play a strong role in opposition to the Cap and Trade.
 - > Four in ten senior manufacturing executives (42%) fear that a Cap and Trade system in the U.S. would put them at a competitive disadvantage on the global stage, while 53% disagree.
 - > Executives who believe they will be at a competitive disadvantage (which are more likely to be the larger companies earning \$250 million or more a year) are more likely to oppose Cap and Trade (80% oppose, including 63% who *strongly* oppose) than those who do not believe they will be at a disadvantage (46%).
 - > Of those optimistic of the six-month U.S. manufacturing sector outlook, 64% disagree that Cap and Trade would put them at a competitive disadvantage, compared with 42% of pessimists.



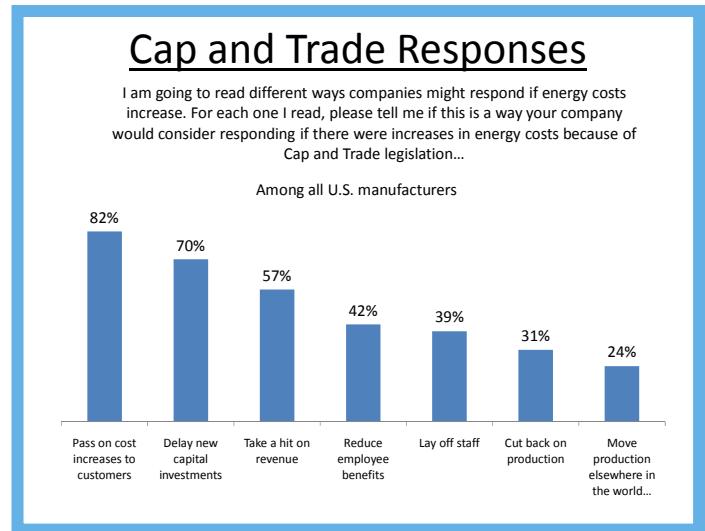
Multilateral approach makes a difference: Guarantees that Cap and Trade would be adopted internationally, rather than taking a go-it-alone approach, evens out support and opposition for the legislation.

- > Overall, four in ten manufacturing executives (40%) said they would be more likely to support Cap and Trade if it was adopted internationally. More importantly, 28% of executives who initially opposed Cap and Trade said this would make them more likely to support the legislation.



Shared pain: If energy prices increase under a Cap and Trade system, most manufacturers plan to pass on costs to their customers.

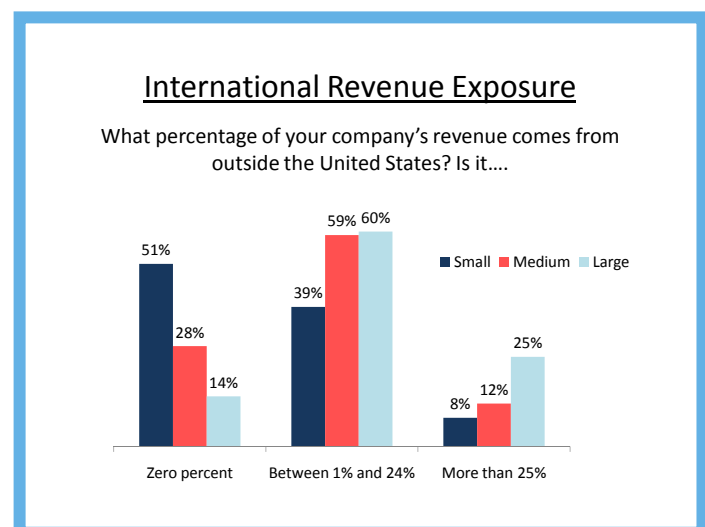
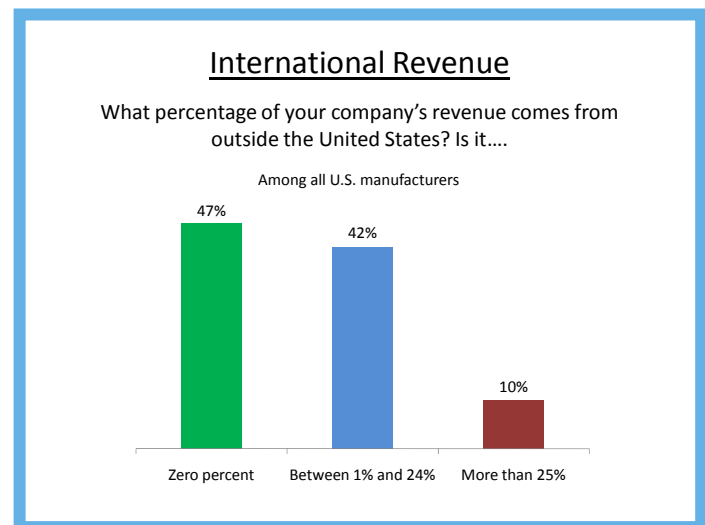
- > If energy costs increase, the most common response by senior manufacturing executives would be to pass on costs to their customers (82% would consider doing this), followed by delaying new capital investments (70%).
 - > Other measures they might have to consider include:
 - Taking a hit on revenue (57%)
 - Reducing employee benefits (42%, more likely among privately owned firms than publicly owned firm, 43% to 19%)
 - Lay off staff (39%)
 - Cut back on production (31%)
 - Move production elsewhere in the world where there are fewer energy restrictions (24%, more likely among larger companies—34% of medium and large companies would consider moving production elsewhere in the world where there are fewer energy restrictions, compared to 23% of small companies).



International commerce

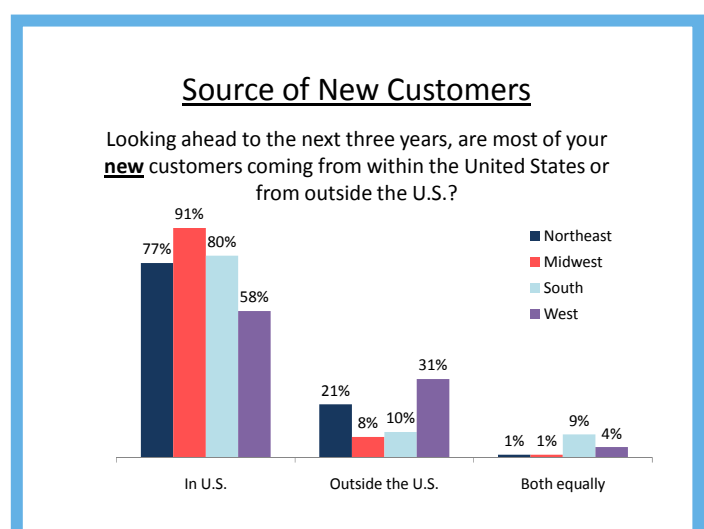
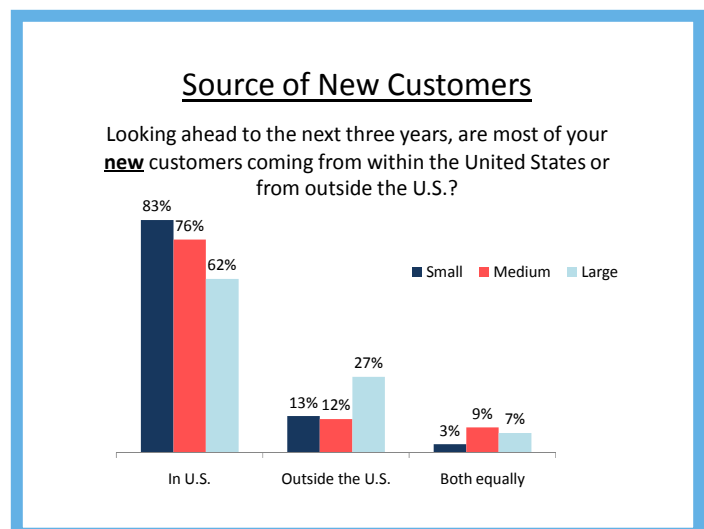
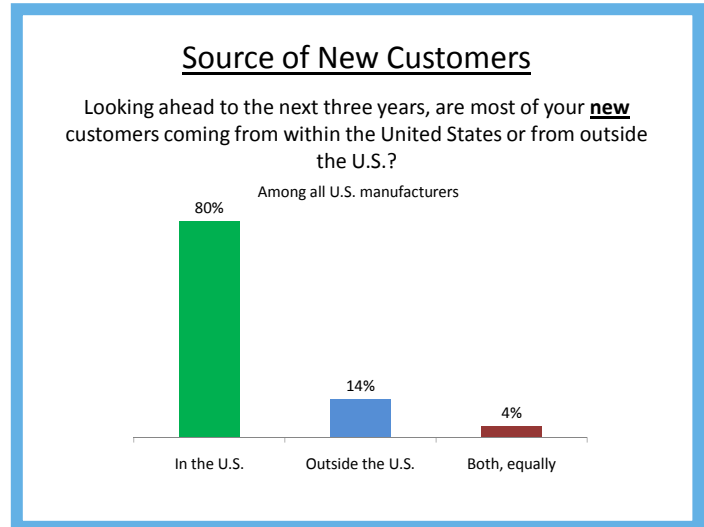
The downturn in international economic markets has generally had an underwhelming effect on manufacturers' expansion plans.

- > Among all U.S. manufacturers, half of senior executives (47%) report their companies have no revenue from outside the country. Among the 52% who do engage in business outside the U.S., 42% are collecting under 25% of their revenue from foreign markets and 10% are collecting 25% or more.
 - > Smaller manufacturers are more likely to be focused on U.S. markets while medium and large companies look to international markets.
 - Executives from half of small manufacturers (51%), said all of their revenue comes from the U.S., compared to 28% of executives from medium and 14% from large companies.
 - Four in ten executives of small manufacturers (39%) said they get under 25% of their revenue from overseas, while six in ten executives from medium (59%) and large companies (60%) claim under 25% of their revenue outside the U.S.
 - Only 8% of executives from small manufacturers and 12% of medium manufacturers said they collect 25% or more of their revenue from other countries. One in four executives from large manufacturers (25%) collects this amount from overseas.

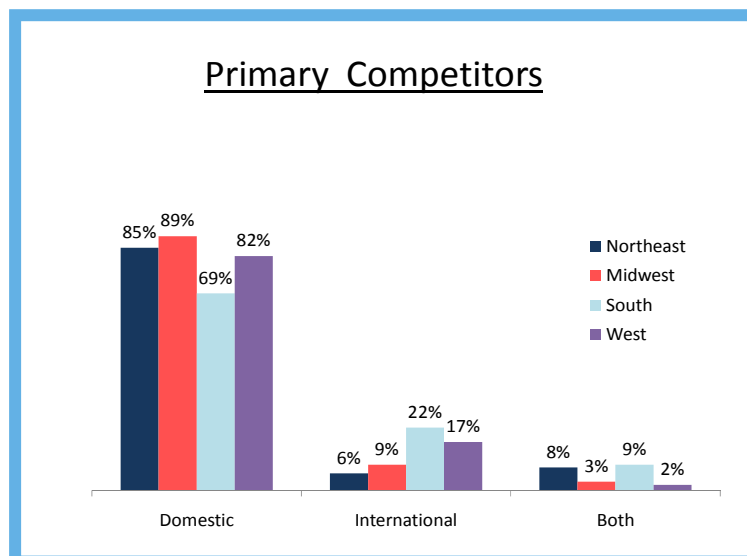
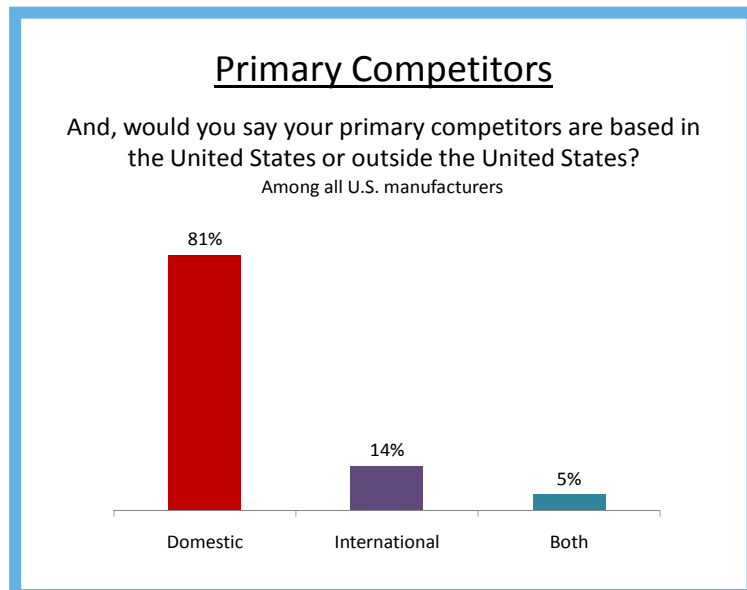


Domestic focus: U.S. manufacturers remain focused primarily on serving domestic markets.

- > Among manufacturers that already derive some revenue from outside the U.S., eight in ten executive (80%) said most of their new customers over the next three years will come from domestic markets. A small minority, 14%, plan for most of their new customers to come from outside the U.S.
 - > However, more than one in four executives from large manufacturers (27%) plans for most of their new customers to come from another country.
 - > Manufacturers based in the western region of the U.S. are more likely to predict most of their new customers coming from outside the United States (31%)
 - > Manufacturers that are more pessimistic about the six-month outlook for the manufacturing sector are also more likely to plan on their new customers to come from foreign markets (20% among pessimists; 6% among optimists).



- > For the same group of manufacturers, eight in ten executives (81%) also said their primary competitors are based in the U.S. and 14% said they are based outside the U.S.
 - > Executives from manufacturers in the South are more likely to see their competition from outside the U.S. (22%) than peers from the Northeast (6%) and Midwest (9%).
- > The current poor economy has led many companies—in particular, medium and large companies—to aggressively pursue foreign markets. Overall, only one in five senior manufacturing executives who already collects revenue from outside the U.S. (22%) said their company has looked for growth opportunities overseas due to the downturn in the economy. While only 18% of executives in small companies report this being the case, four in ten executives from medium and large companies (40%) report the economy forcing their company to expand to markets outside the U.S.
 - > In addition, one in ten manufacturers (13%) and, specifically, four in ten large manufacturers (42%) report they are investing in foreign manufacturing capabilities. This includes 10% of small manufacturers and 19% of medium manufacturers.
 - > In the next three to five years, manufacturers that are involved in commerce outside of the U.S. plan to focus most on China (44%) and Mexico (40%). In addition, one in four companies have plans to increase their presence in Eastern Europe (27%) and India (23%). One in five manufacturing executives indicated they look to do more business in Japan (19%) and Brazil (18%).
 - > Naturally, plans to grow in each of these countries are greater based on the size of the company:
 - China: 39% of small manufacturers, 52% of medium manufacturers, and 68% of large manufacturers plan to increase their role in the next three to five years
 - Mexico: 38%, 43%, 52%
 - Eastern Europe: 24%, 41%, 43%
 - India: 21%, 29%, 29%
 - Japan: 17%, 22%, 28%
 - Brazil: 15%, 29%, 29%
 - Russia: 10%, 14%, 20%
 - Vietnam: 3%, 12%, 12%

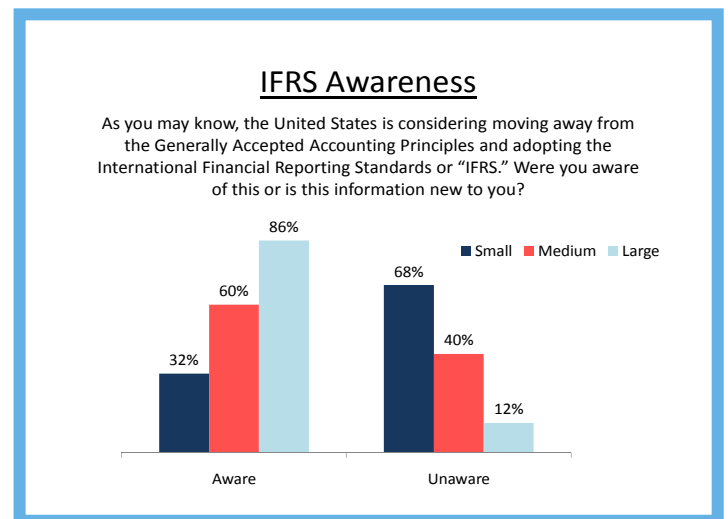
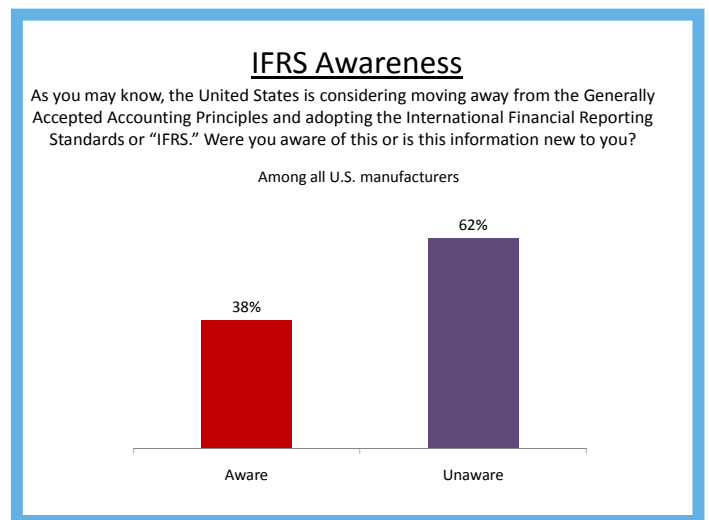


- > Tightening global finance markets have interfered with the foreign-expansion plans of a sizable percentage of companies. Among companies that already derive some revenue from outside the U.S., one in five senior manufacturing executives (19%) said financial markets have strained their ability to expand overseas some or a great deal, including three in ten large companies with 300 or more employees (30%) and nearly half of companies with \$250 million or more in annual revenue (46%).
- > Regulations have had a limited impact on global commerce for U.S. manufacturers. One in ten U.S. manufacturing executives (10%) who have at least some foreign revenue said international regulatory compliance has hindered their global expansion plans some or a great deal. Nine in ten executives (90%) reported having little or no problems.

IFRS accounting standards

Many unaware of potential changes: Most senior manufacturing executives are not aware of the potential adoption in the U.S. of the International Financial Reporting Standards, or IFRS.

- > More than six in ten senior manufacturing executives (62%) are unaware that the United States is considering adopting the IFRS; four in ten (38%) are aware.
 - > Executives of small companies are significantly more likely than those at medium and large companies to be unaware of this transition (68% vs. 24%). Likewise, the overwhelming majority of executives from large companies (86%) were aware, compared to only 32% of those from small companies.
- > There is a general belief that such a change would not have a big impact on their business. One in four manufacturing executives (28%) believes this will have at least some affect on their company's financial reporting process, nearly half (48%) believe it will have little or no effect and one in four (24%) do not know.
 - > Medium and large companies are significantly more likely than small companies to believe that the U.S. adopting the IFRS will have at least somewhat of an effect on their financial reporting process (41% vs. 26%).



> Of those who believe the IFRS will affect their financial reporting process, one quarter (24%) believe that this effect will be a positive one, 37% believe it will be negative and four in ten (39%) do not know.

> Executives from smaller companies are significantly less likely to view the IFRS as having a positive effect (22%) and more likely to not know (41%).

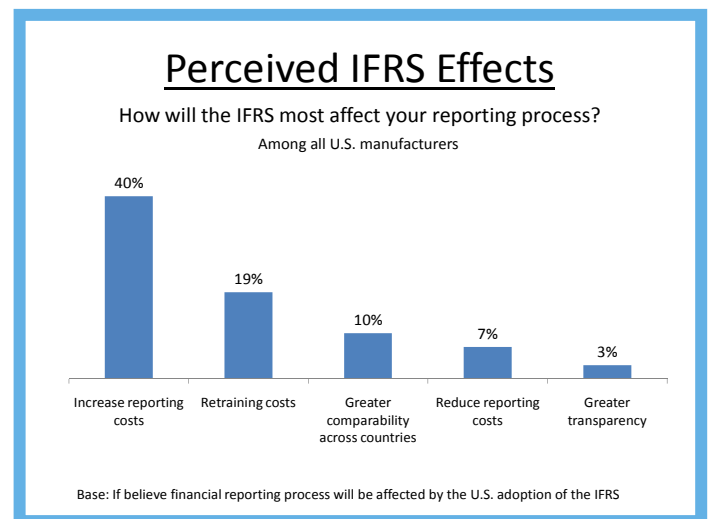
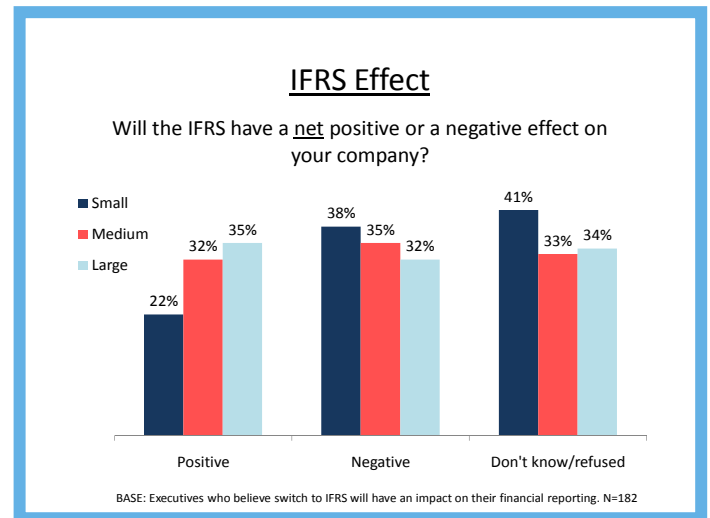
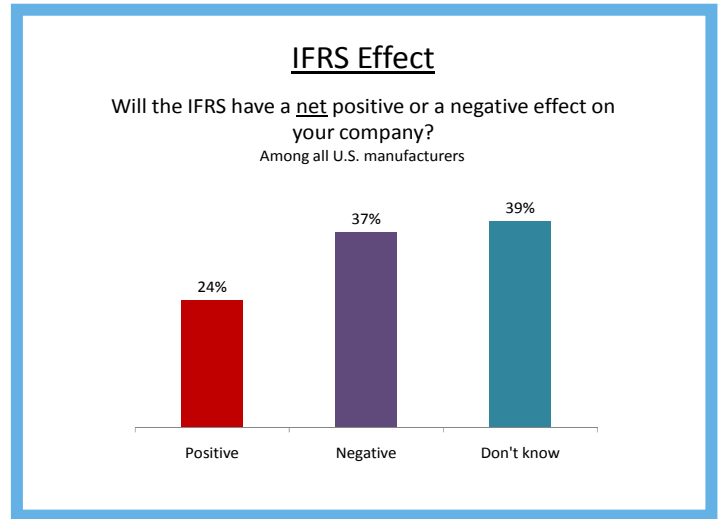
> Executives aware of the possible IFRS changes are more likely than those unaware to believe that this will have a positive affect (31% vs. 16%). Similarly, of executives who were unaware of the IFRS, half (50%) expect the IFRS to have a negative effect, while only a quarter (25%) of those aware of the IFRS have negative expectations.

> The biggest concerns, among those who think the IFRS change would have an impact, are with increased reporting costs (40% said this would affect them), retraining costs (19%), and—on a positive note—would lead to greater transparency (10%). One in five executives (21%) did not know how it would affect their reporting process.

> Executives from medium and large companies are significantly more likely than executives from small companies to believe the IFRS will most affect the reporting process by increasing comparability across countries (23% vs. 7%).

> Executives from small companies are more likely to view the IFRS' largest effect as a hindrance: 43% of executives from small companies believe the IFRS will lead to increases in reporting costs, compared to 28% of executives from medium and large businesses.

> Of executives unaware of the possible IFRS change, nearly half (49%) believe the IFRS will lead to higher reporting costs, compared to only a third (33%) of those who are aware of the IFRS.



Methodology

On behalf of Baker Tilly, KRC Research conducted a national telephone survey of 300 senior executives of U.S. manufacturing companies between June 2 and June 22, 2009. The sample was stratified to include sufficient interviews to analyze results between executives from small (n=148), medium (n=81) and large manufacturers (n=71). The sizing of each company was based on the number of employees; small companies have fewer than 100 employees, medium companies have 100 to 299 employees and large companies have 300 or more employees. Overall results were weighted to reflect the actual proportion of manufacturers of each size in the United States. The estimated margin of error is ± 5.7 percentage points at the 95% confidence level. The full questionnaire and results are appended at the end of this document.

Demographic profile of sample

Number of Employees	
Less than 100 employees	87%
100 to under 300 employees	5%
300 to under 600 employees	3%
600 to under 1,000 employees	2%
1,000 or more employees	3%
Annual Revenue	
Less than 1 million dollars	39%
1 million to under 25 million dollars	42%
25 million to under 100 million dollars	10%
100 million to under 250 million dollars	2%
250 million to under 500 million dollars	1%
500 million to under 1 billion dollars	*%
More than 1 billion dollars	2%
Region	
Northeast	17%
Midwest	37%
South	30%
West	17%
Ownership	
Privately owned	93%
Publicly owned	7%
Gender	
Male	71%
Female	29%

Contacts

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