2017
Manufacturing Industry Outlook Report

OVERVIEW

Manufacturers are largely positive about where their industry is heading. That optimism has been fueled, in part, by the results of the 2016 elections. With the Republicans taking control of the White House and both chambers of Congress, along with winning major gubernatorial victories across the country, the sector remains hopeful that there will be changes favorable to U.S. businesses.

Promises of tax and health care reform, decreased federal regulations and fairer trade agreements buoyed the public stock markets following the election. And the effects have trickled down to the private manufacturers who responded to our survey.

So far, little headway has been made on the pro-business agenda. The Trump administration has encountered significant resistance and controversy. As delays mount, how long will manufacturers maintain their sunny outlook? Here's insight gathered straight from the trenches this spring.

EXECUTIVE SUMMARY

Our survey revealed that manufacturers generally **expect continued growth** in 2017. A significant source of growth will be **existing U.S. markets,** but **new innovative products and services** could add to the mix. Other growth opportunities will come from external sources, such as **mergers and acquisitions.**

Companies also report a **variety of challenges** that threaten growth. These include **weakening domestic demand, a lack of qualified workers and rising operating costs,** such as the cost of providing health care coverage for employees.

OVERVIEW

Manufacturers strive to **control their costs** and invest wisely to **facilitate growth strategies.** Many companies expect to increase their budgets for **marketing and sales, research and development, capital expenditures, and technology** in 2017. These are more than routine operating expenses — they're investments in the future to drive continued revenue growth.

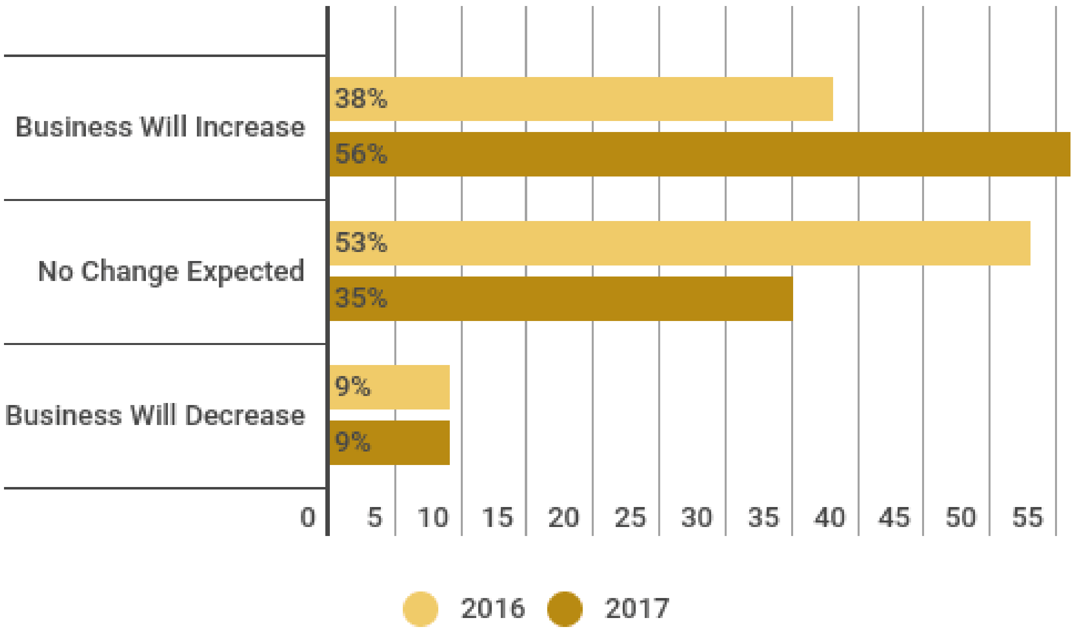
Tax reform is a top concern for manufacturers, but there's no single proposal that's garnered the industry's support. Many respondents favor **lower income tax rates for businesses and individuals.** But a significant number look unfavorably on such reforms as border taxes, tariffs on imports, elimination of the interest deduction and temporary relief for repatriated foreign profits.

Big questions remain as we head into the second half of 2017: Will Congress pass tax reform and other pro-business legislation in the coming months? Or will they miss this unique opportunity to simplify the tax code and make other changes that will enhance growth opportunities for U.S. businesses? Until these questions are answered, manufacturers will operate in an **uncertain business environment.**

"Although we are living in uncertain times, it is good to see a continued sense of optimism in the manufacturing sector. The innovation that is being driven through our U.S. manufacturers will continue to provide growth opportunities globally," said Paul Oliveira, Shareholder and Chair of KLR's Manufacturing Services Group. **"Of course, there are always challenges. We hope that this survey will provide some insight on where those challenges — and potential solutions — lie."**

REVENUE GROWTH

WHAT ARE YOUR EXPECTATIONS ON HOW YOUR INDUSTRY WILL PERFORM OVER THE NEXT 12 MONTHS?



In general, manufacturers are optimistic about industry growth prospects for the coming year — even more so than in 2016.

Negative sentiment remained consistent at 9% from 2016 to 2017. But **positive sentiment grew from roughly one-third of respondents in 2016 to more than half of the respondents in 2017.**

34% expect the year-over-year increase to exceed 5%.

REVENUE GROWTH

KLR

TOP BUSINESS PRIORITIES

The following actions are the top company priorities for 2017

1. Increasing Share in Existing Markets
2. Seeking New Markets for Products and Services
3. Developing New Products and Services in Response to Changing Consumption Patterns

All three of these priorities are directly related to revenue growth.

Over the next 12 to 18 months, 64% of the manufacturers surveyed expect their growth to come mainly from **increased market share and organic growth in existing domestic markets.** These findings are consistent with the responses from 2016.

REVENUE GROWTH

M&A ACTIVITY

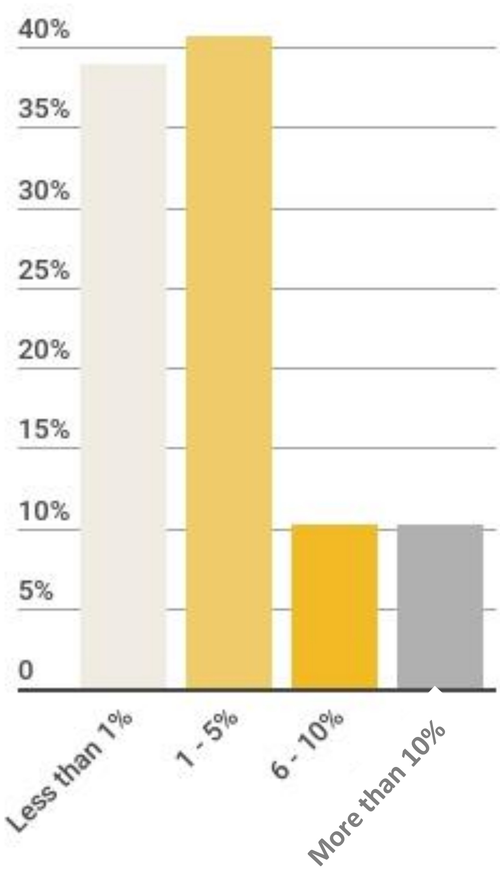
Mergers, acquisitions, joint ventures and strategic alliances are seen as a top growth opportunity by 16% of respondents. But only 7% of respondents are considering a merger or acquisition in 2017, compared to nearly 29% in the previous survey.

10% of respondents made a strategic acquisition during 2016.

INVESTMENT IN R&D

Under the current law, the **research credit has been made permanent.** Moreover, this credit hasn't yet been targeted by congressional tax reform proposals. So, it's likely to continue to provide tax savings in the future.

Projected R&D Spending as a Percentage of Revenue



One-fifth of respondents are investing **6% or more** of their revenue in

developing new products.

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CHALLENGES

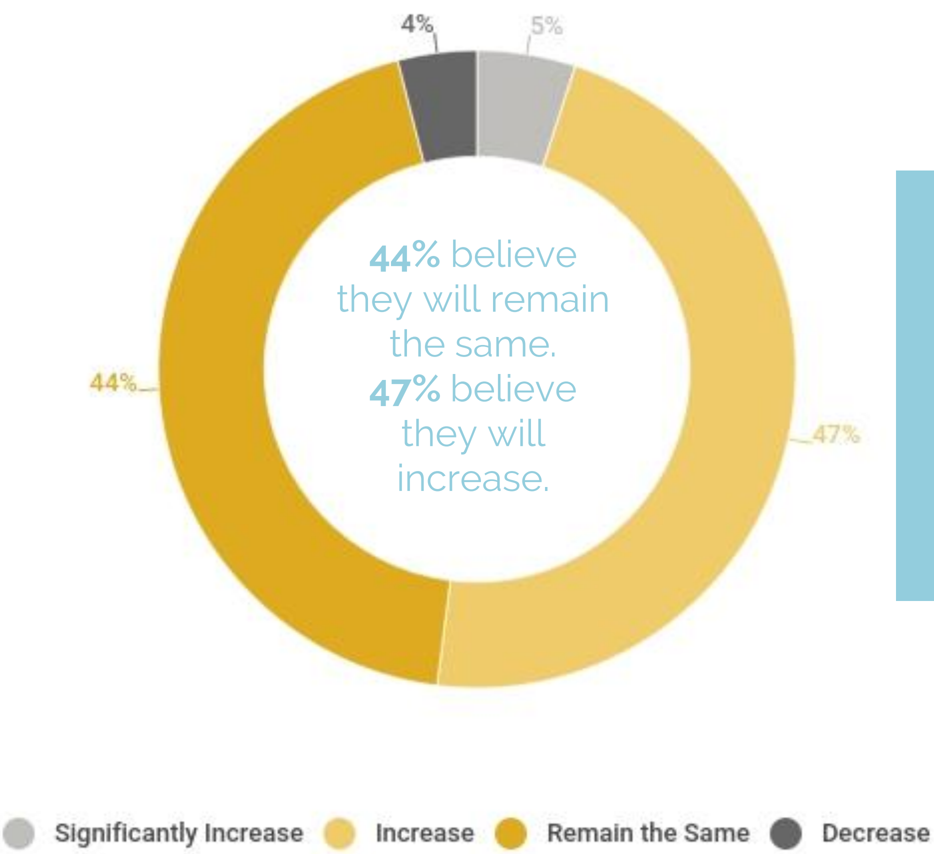
BARRIERS TO GROWTH

TOP 3 EXPECTED BARRIERS TO BUSINESS GROWTH IN 2017

1. Weaker Domestic Economy and Sales of Products
2. Lack of Qualified Workers
3. Rising Health Care Costs

OPERATIONAL COSTS

OPERATING COST EXPECTATIONS OVER THE NEXT 12 MONTHS



Accordingly, nearly **40%** of respondents identify **cutting operating costs** as a top priority for 2017.

SPENDING & INVESTMENT

BUSINESS DRIVERS IMPACTING TECHNOLOGY STRATEGIES

#1 Improve Performance of Existing Systems

#2 Implement a CRM Database

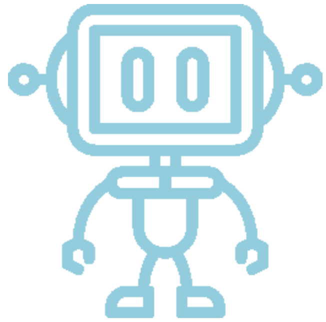
#3 Enhance Data Security

#4 Invest in Social Media Capabilities

#5 Add New ERP or Core Operating Systems

Technology investments are another top priority for many manufacturing firms in 2017. **Nearly 40%** of respondents expect to **upgrade information technology,** and roughly **one-third** plan to **invest in automation** to modernize their operations.

40%



OPERATIONAL SPENDING

The number of respondents expecting to **increase spending on Internet commerce** fell from 38% in 2016 to 17% in 2017. This change suggests that many manufacturers have their e-commerce capabilities up and running.

EXECUTIVES EXPECT OPERATIONAL SPENDING IN 2017 TO INCREASE ON:

1. Marketing and Sales
2. New Product or Service Introduction
3. Information Technology
4. Advertising
5. Automation

TAXES & TAX REFORM

Taxes are always a hot button for businesses. Before pursuing their capital investment plans, manufacturers may be waiting to see what happens in Washington with the promised pro-business changes to the tax code.

TOP PRO-BUSINESS TAX REFORMS

#1 Lower the Corporate Income Tax Rate to 20%

#2 Lower the Top Personal Income Tax Rate to 30%

#3 Allow Immediate Deductions for New Investments

#4 Ease the Repatriation of Foreign Profits

51% say lowering corporate income taxes would be **"good" or "very good"** for the economy.

11% say easing the repatriation of foreign profits would be **"good" or "very good"** for the economy, even though half of the respondents operate internationally.

Manufacturers don't universally agree with all of the proposed tax reforms, however.

TOP PRO-BUSINESS TAX REFORMS

TAX REFORM PROPOSALS THAT THREATEN THE ECONOMY

1. Tariffs on Chinese and Mexican Imports
2. Border Taxes
3. Elimination of Interest Deduction on Debt

Nearly **40%** of respondents oppose tariffs on imports and border taxes. **One-quarter** think it's in the best interests of the economy for interest on debt to remain deductible for tax purposes.

SURVEY & RESPONDENTS

RESPONDENT OVERVIEW

KLR's 2017 Manufacturing Industry Outlook Report is based on the results of our confidential, web-based survey that was conducted using SurveyMonkey.com, an online survey provider.

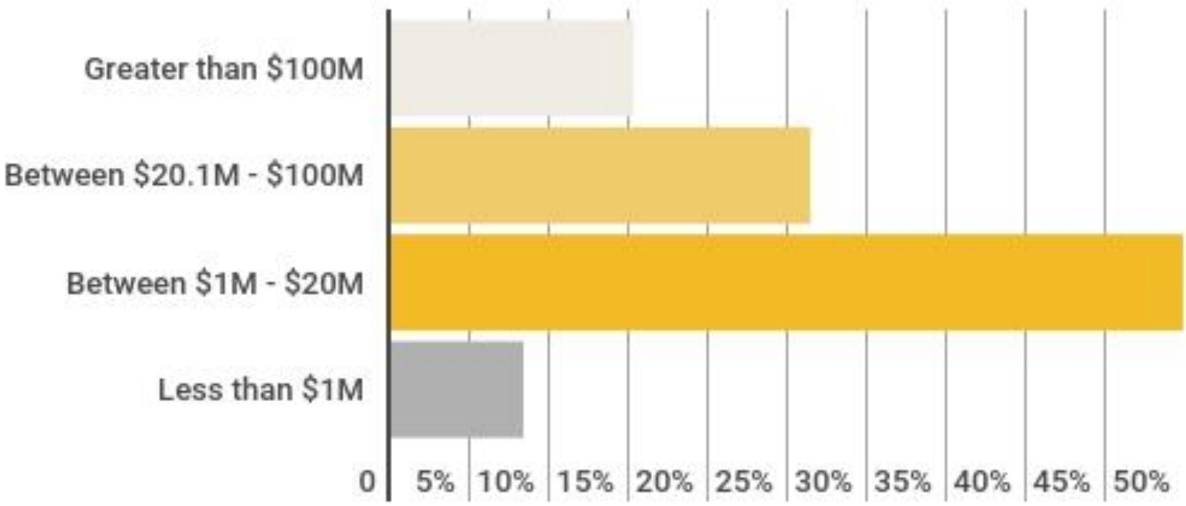
From May 2 to May 31, 2017, 136 manufacturing companies responded to our survey. It consisted of 18 questions about a wide range of topics, such as growth expectations, challenges and opportunities, direct costs, and capital expenditures.

We solicited feedback primarily from owners, **CEOs and senior-level executives** of New England manufacturing companies. In addition, we received responses from two companies headquartered in the West and three companies headquartered outside of the United States. Of those surveyed, **50% engaged in international operations.**

Most of the respondents had between **$1 million to $50 million** in annual revenue. But there were a significant number of very small and very large companies involved in the survey. **15% had more than $100 million in annual revenues.**

SURVEY & RESPONDENTS

ANNUAL REVENUE



Respondents also varied in size. More than half of our responses came from manufacturers with $20 million or less in annual revenues. But 15% had more than **$100 million** in annual revenues.

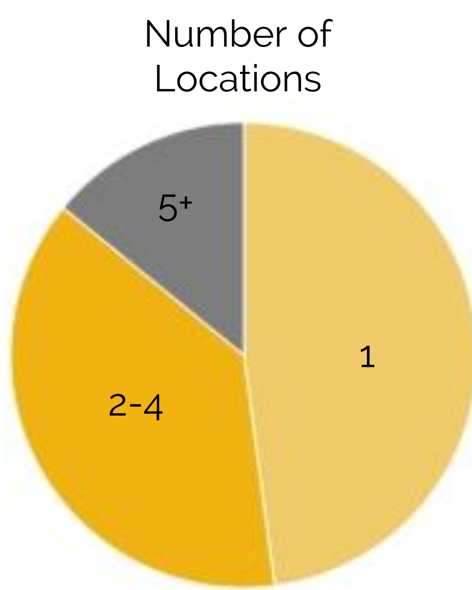
Roughly **70%** of respondents had 100 or fewer employees.

Most operated in **four locations** worldwide (or fewer).

NUMBER OF LOCATIONS WORLDWIDE

≤100

Roughly 70% of respondents had 100 employees or fewer. **Most operated in four locations worldwide (or fewer).**



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LOOKING TO THE FUTURE

Responses from New England's manufacturing trenches are primarily upbeat, despite various potential roadblocks and uncertainty about possible tax reforms. Many companies are making investments to set the stage for future growth.

Contact us for help planning optimal short- and long-term strategies, based on your size, sector and available resources. We can also help to identify opportunities to control your costs, anticipate and tackle obstacles, evaluate investment opportunities and stay up-to-date on the latest changes to federal regulations, health care coverage requirements and tax law.

ABOUT US

KLR is one of New England's premier accounting and business advisory firms. With 225+ team members and offices in **Boston**, Newport, Providence, Shanghai and Waltham, KLR provides a wide range of **services** to both individuals and businesses.

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