Delivering on the Promise of connecting our manufacturing and distribution world to you.

SURVEY OF NORTHEAST OHIO’S MANUFACTURING AND DISTRIBUTION INDUSTRY

January 2017 | Volume 1
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MANUFACTURING AND DISTRIBUTION EXECUTIVE SUMMARY

2016 marks the inaugural year of the Skoda Minotti Manufacturing and Distribution Survey. I would like to thank our partners at WIRE-Net for their help in making our first survey such a success. Respondents weighed in on a wide range of business topics—from the availability of skilled labor and challenges associated with workforce development, to keeping material costs in check, prospects for pursuing expansion in Northeast Ohio and beyond, and more.

Overall, survey results signaled cautious optimism; but they also pointed to some worrying signs based on specific responses, and our subsequent analysis of those responses within a broader contextual framework. Generally, most respondents continue to face many of the same challenges they have faced for years—rising material costs and the ability to find skilled labor to fill jobs were the number-one and number-two most cited concerns respectively. Yet respondents seem unsure whether new strategies or methods to address these challenges will ever surface.

We welcome your thoughts and feedback about this year’s survey.

About WIRE-Net:

WIRE-Net is a membership-based, non-profit economic development organization that provides services to manufacturing leaders to strengthen their businesses, create healthy communities and fuel economic growth. WIRE-Net has 350 members that employ over 20,000 people across greater Cleveland.

For more information, visit www.wire-net.org

About Skoda Minotti Manufacturing and Distribution Group:

As a firm, we have a long history of providing services to the manufacturing and distribution industry, working with thousands of manufacturers and distributors from a variety of sectors. We apply insights learned from the industry to our team through process improvement initiatives and incorporating LEAN accounting concepts. Many of our professionals have actual industry experience, bringing first-hand expertise to the group. With Skoda Minotti, you receive a wealth of expertise that comes from over 100 collective years of focusing on the manufacturing and distribution industry.

For more information, visit www.skodaminotti.com

Jonathan Shoop, CPA
Which of the following actions are among your company's top priorities

<table>
<thead>
<tr>
<th>Action</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cutting operational costs</td>
<td>69%</td>
</tr>
<tr>
<td>Developing new products and services in response to changing consumption patterns</td>
<td>63%</td>
</tr>
<tr>
<td>Seeking new markets for products/services</td>
<td>61%</td>
</tr>
<tr>
<td>Long-term strategic planning</td>
<td>56%</td>
</tr>
<tr>
<td>Organizational planning; responding quickly to changing economic conditions</td>
<td>44%</td>
</tr>
<tr>
<td>Seeking M&amp;A opportunities</td>
<td>41%</td>
</tr>
<tr>
<td>Short-term strategic planning</td>
<td>33%</td>
</tr>
<tr>
<td>Restructuring company to position for growth</td>
<td>31%</td>
</tr>
<tr>
<td>Restructuring management team</td>
<td>25%</td>
</tr>
<tr>
<td>Reconfiguring supply chain</td>
<td>9%</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>5%</td>
</tr>
</tbody>
</table>

The Good News: New Product Development May Be on the Rise

Sixty-two percent of respondents ranked developing new products and services as their company’s top priority. Slightly more respondents – 68.8 percent – cited cutting operational costs as their top priority. We find this result pleasantly surprising; Northeast Ohio, Ohio and the Midwest aren’t generally known as hotbeds of innovation, so this could signal a small but significant paradigm shift among middle-market companies toward business growth through innovation.

The Not-So-Good News: Same Challenges, Different Day

As mentioned, longtime manufacturing and distribution industry challenges, such as finding skilled labor
Reshoring – Competitive Advantages Have Boosted Its Popularity

For nearly the past 30 years, manufacturers throughout the U.S. have “offshored” labor jobs to overseas markets with lower wages. While this competitive strategy succeeded at reducing labor costs, labor is but one facet of company profitability.

Today, we are seeing many companies – throughout the U.S. and here in Northeast Ohio – bringing those same jobs back through a relatively new trend called “reshoring.”

Understanding the Hidden Costs of Offshoring

What do many foreign markets offer that make offshoring so enticing? The answer is three-fold: inexpensive labor, materials and real estate. Yet look past these, and some of offshoring’s hidden costs soon become evident, including freight costs, longer supply chains, excise taxes and more.

There’s more. Many manufacturers have experienced a drop-off in product quality. Others have been unable to make changes to products in adequate timeframes, and still others have found that internal innovation has stagnated as a result of long distances and awkward time differences.

Finally, labor costs – long the key driver of most offshoring – have begun to rise in many emerging countries, including China. So, the most attractive offshoring incentive for many companies is becoming less attractive as time moves forward.

Reshoring Suddenly Makes Lots of Sense

We’ve heard politicians, employers, workers and others bemoan the loss of American jobs over the preceding decades. Yet offshoring is now revealing itself as a driver of corporate waste and instability in the manufacturing sector, throughout Ohio and the U.S. When you consider that the cost of energy, labor, transportation and materials overseas has dramatically increased in recent years, manufacturing closer to home starts to look like a good, sensible decision.

Besides bringing jobs back to Ohio and other states, reshoring helps to boost product and service quality, encourage innovation, and reduce waste and cost. All that, in turn, drives return on investment (ROI).

Is Reshoring for Your Business? TCO May Hold the Answer

When considering the benefits and costs of offshoring and reshoring respectively, there are many factors to weigh. Simply looking at one without putting it in proper context won’t yield an informed and strategic result. Manufacturers need to consider the total cost of ownership (TCO) to determine whether they are truly saving money. In other words, price alone doesn’t tell the whole story.

Companies also need to look at issues including risk management, profit impact, shipping and travel costs and well as several others.

According to the Boston Consulting Group, an American worldwide management consulting firm that studies the impact of the shifting economics of global manufacturing, TCO can have a great impact on where a company decides to manufacture. Rather than looking at a large price gap, companies should look at what can be a small TCO gap. According to BCG, the total cost of production in China and the U.S. converged in 2015.

Underscoring that fact are the findings of BCG’s fourth annual survey of U.S-based manufacturing executives which reveal “a significant shift in U.S. attitudes toward manufacturing in America in just a few years.”
I am glad to see that these manufacturers focus on sales as a business threat, because this demonstrates that each views their business from a different operational perspective. As a result, their focus will not only be on cost-cutting metrics and LEAN and Six Sigma Kaizens; it will also be geared toward building and growing their business.

Jonathan Shoop, CPA, principal, Skoda Minotti Manufacturing and Distribution Group

The Surprising News: Globalization Seems Far Off the Radar

The world as a global marketplace? Not so much, according to most respondents. Only 3.1 percent ranked new operation in foreign markets as their company’s main opportunity to grow over the next 12-18 months. That ranked seventh out of eight possible responses. None ranked organic growth in existing foreign markets as a top priority.

The reasons for this are likely multifaceted. Chief among them may be the dollar—today, it is strong relative to many global currencies, and has been so for
about 18 months. Exports, therefore, are a challenge for many U.S. businesses, since the dollar holds higher value than other currencies, which makes it price incomparable.

Yet other factors may also be in play. For example, U.S. companies still face far greater barriers to entry for foreign investments then they do for expansion here in the U.S. One thing, however, remains certain: President-elect Trump has talked tough about trade relations, so industry insiders will carefully monitor U.S./global relations – and specifically the status of current trade pacts and negotiations – once the Trump administration takes over in January.

In terms of growth closer to home, respondents envision more expansion opportunities outside of Northeast Ohio than within Northeast Ohio. Our analysis suggests that while respondents may not expect deterioration of sales within Northeast Ohio, they don’t necessarily see it as an area of growth.

The Head-Scratching News: Tax Incentives Aren’t as Popular as They Should Be

Northeast Ohio manufacturing and distribution businesses can leverage many attractive tax incentive programs to offset costs and boost profits. Among these are InvestOhio, R&D tax credits, work opportunity credits, the Ohio Small Business Deduction and the Domestic Production Activities Deduction. More than half of all respondents reported utilizing one or more of these programs. Yet overall utilization seemed disarming low. The most popular incentive by far among respondents was the R&D tax credit program, with 31.3 percent reporting having utilized it. All other programs listed in the survey averaged a paltry 11.86 percent. Even at 31.3 percent, R&D utilization seems low, especially when one considers the numerous potential qualifying activities that are inherent in the manufacturing and distribution sector.

Given that 68.8 percent of respondents cited cutting operational costs as their top priority in 2017, we think tax incentive utilization could represent a significant opportunity for companies to achieve the cost-savings they desire without impacting product or service quality, delivery time, or internal resources.

What do you see as the main opportunity to grow your business in the next 12-18 months?

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking (tightened credit, interest rates, etc.)</td>
<td>5%</td>
</tr>
<tr>
<td>Industry consolidation</td>
<td>3%</td>
</tr>
<tr>
<td>Labor costs</td>
<td>5%</td>
</tr>
<tr>
<td>Securing skilled labor</td>
<td>20%</td>
</tr>
<tr>
<td>Competition</td>
<td>6%</td>
</tr>
<tr>
<td>Material costs</td>
<td>6%</td>
</tr>
<tr>
<td>Lack of orders / sales dollars</td>
<td>38%</td>
</tr>
<tr>
<td>Other, please list</td>
<td>17%</td>
</tr>
</tbody>
</table>

Which of the following actions are among your company’s top priorities

<table>
<thead>
<tr>
<th>Action</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>InvestOhio</td>
<td>13%</td>
</tr>
<tr>
<td>Work opportunity credits</td>
<td>11%</td>
</tr>
<tr>
<td>R&amp;D tax credit</td>
<td>31%</td>
</tr>
<tr>
<td>Ohio Small Business Deduction</td>
<td>9%</td>
</tr>
<tr>
<td>Domestic Production Activities Deduction</td>
<td>16%</td>
</tr>
<tr>
<td>Don’t know</td>
<td>11%</td>
</tr>
<tr>
<td>Other (please specify)</td>
<td>44%</td>
</tr>
</tbody>
</table>
UPDATE: The Affordable Care Act

By Ted Ginsburg, CPA, JD

While the Affordable Care Act (ACA) has now been in effect for several years, its ripple effects continue to be felt by businesses as additional requirements are rolled out. In 2016, the ACA became effective for employers that average 50 or more full-time equivalent employees. As we go to press, the Trump administration is preparing to take office; a key part of their agenda is the repeal or significant restructuring of the ACA. We can’t foresee the future, but we believe there will be changes. Until those changes are finalized, here are some things to consider.

INCREASED ENFORCEMENT

The IRS is initiating enforcement actions for employers that fail to file and for those with inadequate filings. Employers that fail to send their employees their required 1095 form on a timely basis will be penalized $250 for each form that’s not sent out. Penalties were not assessed for the 2015 forms if the employer could show that they made a ‘good-faith’ effort to comply.

CADILLAC TAX

When the value of an employee’s health coverage exceeds a certain dollar level, the employer triggers a 40% excise or “Cadillac” tax on any amount that exceeds that level. While the tax won’t be imposed until 2020, employers should know that most employer plans, as well as those collectively bargained, will be subject to it as the trigger amount is low. Therefore, employers should begin to think about how they can provide less of a benefit to employees and still be in compliance with ACA guidelines. Employers would be wise to work with a trusted advisor to consider changes in program design, employee contribution levels and preparation of 1095 forms.

SMALL EMPLOYERS CAN OFFER REIMBURSEMENT PROGRAMS

The “21st Century Cures Act” allows small employers to offer health coverage through a reimbursement program. Prior to the Act, employers who allowed employees to obtain their own coverage, and then reimburse them for the premiums on a pre-tax basis, would be subject to a potential $36,500 annual excise tax per employee on that reimbursement. At that time, our advice to clients who wanted employees to acquire their own coverage was to include that reimbursement on the employee’s W-2 as taxable income—so that wasn’t as tax effective as an employer sponsored health insurance program (which would be income tax free) to the employee.

The Act now allows pre-tax reimbursement if the following conditions are met: the employer is not subject to the ACA because the employer has less than 50 full-time equivalent employees; the program is offered on the same terms to all eligible employees; a health reimbursement account is created that will reimburse the employee upon showing proof of payment of premiums; and the maximum annual reimbursement is $4,950 for single coverage and $10,000 for coverage which includes family members.

Small employers who have had difficulty in obtaining group coverage, or who want to put a fixed limit on their liability (you can reimburse less than the amounts indicated above) for insurance coverage should consider this as an alternative to obtaining a group plan.

LOOKING AHEAD

- While unlikely before 2018, the IRS will begin to assess an excise tax for failure to provide the right amount of insurance to employees
- The IRS is standing by the 1095 series of forms, which are due March 2, 2017
RESULTS

1. What is your specific industry?
   Contract manufacturing .............................................. 26%
   Equipment manufacturing ........................................ 16%
   Steel or steel related ................................................ 6%
   Tool & die ................................................................. 4%
   Plastics or polymers .................................................. 5%
   Chemical ................................................................. 9%
   Distribution ............................................................... 15%
   Transportation ......................................................... 5%
   Other ........................................................................ 14%

2. Please indicate your company’s annual revenue.
   Under $10 million ..................................................... 37%
   $10 million to $19.9 million ..................................... 14%
   $20 million to $49.9 million ..................................... 20%
   $50 million to $124.9 million ................................... 18%
   More than $125 million ........................................... 11%

3. Please indicate the number of employees at your company.
   Less than 50 ............................................................ 49%
   50 to 99 ................................................................. 16%
   100 to 249 ............................................................ 21%
   More than 250 ......................................................... 14%

4. What business issues will most impact your company in 2017?
   Labor availability .................................................... 1st
   Healthcare reform and insurance rates
     (health, liability, etc.) ........................................... 2nd
   Labor/workforce development ................................ 3rd
   Material cost ........................................................... 4th
   Material price volatility .......................................... 5th
   Income tax rates ....................................................... 6th
   Availability of credit (bank financing) ..................... 7th
   Environmental regulation ....................................... 8th
   Sustainability/energy efficient initiatives ................. 9th

5. Which of the following actions are among your company’s top priorities? (Check all that apply)
   Cutting operational costs ....................................... 69%
   Developing new products and services in response to changing consumption patterns .................. 63%
   Seeking new markets for products/services ............ 61%
   Long-term strategic planning .................................. 56%
   Organizational planning; responding quickly to changing economic conditions ...................... 44%
   Seeking M&A opportunities .................................... 41%
   Short-term strategic planning .................................. 33%
   Restructuring company to position for growth ................……………………………………… 31%
   Restructuring management team ......................... 25%
   Reconfiguring supply chain .................................... 9%
   Other ...................................................................... 5%

6. Are you planning capital expenditures in any of the following areas in 2017? (Check all that apply)
   Manufacturing equipment ...................................... 64%
   Computer software ................................................ 47%
   Computer hardware ................................................ 34%
   Plant expansion/modernization ............................... 27%
   Office equipment .................................................... 11%
   Transportation equipment ...................................... 9%
   Other ...................................................................... 8%

7. Have you taken advantage of any of the following tax incentives? (Check all that apply)
   InvestOhio ............................................................... 13%
   Work opportunity credits ....................................... 11%
   R&D tax credit ......................................................... 31%
   Ohio small business deduction .............................. 9%
   Domestic production activities deduction ............ 16%
   Don’t know .............................................................. 44%
   Other ...................................................................... 11%
8. What do you see as the main opportunity to grow your business in the next 12-18 months?
- Increased share in existing markets: 30%
- New product or service development: 26%
- M&A: 16%
- New geographic markets: 11%
- Organic growth in existing domestic market: 9%
- New joint ventures and/or strategic alliances: 5%
- New operation(s) in foreign markets: 3%
- Organic growth in existing foreign market: 0%

9. How important is supply chain management to your plant’s success over the next five years?
- Extremely important: 23%
- Very important: 30%
- Moderately important: 34%
- Slightly important: 11%
- Not at all important: 2%

10. In the next 3 years in Northeast Ohio, do you see your business having
- More opportunities in Northeast Ohio: 27%
- Less opportunities in Northeast Ohio: 8%
- Same amount of opportunities in Northeast Ohio: 65%

11. In the next 3 years outside of Northeast Ohio, do you see your business having
- More opportunities outside of Northeast Ohio: 83%
- Less opportunities outside of Northeast Ohio: 2%
- Same amount of opportunities outside of Northeast Ohio: 15%

12. In the next 12 months, do you expect your business’ raw materials costs to:
- Significantly increase: 2%
- Increase: 61%
- Stay the same: 35%
- Decrease: 2%
- Significantly decrease: 0%

13. In the next 12 months, do you expect your business’ taxation costs to:
- Significantly increase: 2%
- Increase: 45%
- Stay the same: 51%
- Decrease: 2%
- Significantly decrease: 0%
14. In the next 12 months, do you expect your business’ labor costs to:
- Significantly increase: 2%
- Increase: 76%
- Stay the same: 20%
- Decrease: 2%
- Significantly decrease: 0%

15. What do you see as the biggest threat to your business over the next 12 months?
- Banking (tightened credit, interest rates, etc.): 3%
- Industry consolidation: 5%
- Labor costs: 6%
- Securing skilled labor: 17%
- Competition: 20%
- Material costs: 6%
- Lack of orders / sales dollars: 38%
- Other: 5%

16. In how many states do you have operations?
- 1: 49%
- 2-10: 32%
- 11-20: 6%
- Over 20: 13%

17. Has your company been involved in any use tax audits?
- Yes: 33%
- No: 67%

18. In 2016, international sales have:
- Increased: 33%
- Decreased: 8%
- Remained the same: 33%
- N/A: 26%

19. Has your company initiated a merger or acquisition this year?
- Yes: 25%
- No: 75%

20. Is your company considering a merger or acquisition next year?
- Yes: 38.1%
- No: 1.9%

21. Do you feel that over the past year the ability to obtain financing has:
- Increase: 19%
- Stayed about the same: 76.2%
- Decreased slightly: 4.8%
- Decreased significantly: 0%
“Skoda Minotti has helped Brennan Industries grow the past seven years by providing accounting, tax, staffing, marketing, international tax and mergers and acquisitions. They are more than a firm that provides business solutions; they are a true partner.”

David Carr
CEO

How Can We Help Your Business Grow?

FIRM OFFERINGS: CPA & Business Advisory | Financial Services | Professional Staffing | Risk Advisory Services
Strategic Marketing | Technology Solutions | Valuation & Litigation Services

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