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Manufacturing Barometer

Business outlook report
April 2011

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Contents

Quarterly highlights

Key findings:

In the first quarter of 2011, PwC interviewed 63 US-based industrial manufacturing executives about their current business performance, the state of the economy, and their expectations for business growth over the next 12 months. We then compared their responses with results from prior quarters to see how the panel's 12-month outlook has changed. Overall, own-company revenue forecasts improved slightly, but uncertainty emerged about prospects for the world economy. Oil/energy prices, which surged during the first quarter, top the list of potential barriers to growth over the next 12 months. Spending was up, as costs and prices were on the rise.

- **Uncertainty is building.** Looking at the next 12 months, 57 percent of industrial products manufacturers are optimistic about the US economy, down only 6 points from the prior quarter. Thirty-eight percent are uncertain, up 8 points, and only 5 percent remain pessimistic. Respondents' views of the world economy over the next 12 months showed more change, with 44 percent expressing optimism, down 16 points from last quarter. The majority, 51 percent, are uncertain. That's a 13-point climb from the prior quarter. However, only 5 percent remain pessimistic.
- **Revenue projections improve.** The projected average growth rate for own-company revenue over the next 12 months rose from 6.6 percent in the prior quarter to 7.0 percent in first-quarter 2011. This rate more than doubles the 3 percent average growth rate reported a year ago. Eighty-nine percent expect positive revenue growth for their own companies in the year ahead, with 33 percent forecasting double-digit growth and 56 percent single-digit growth. Only 5 percent forecast negative growth, 2 percent zero growth, and 4 percent did not respond.
- **International sales contribution dips.** Industrial products manufacturers marketing abroad expect international sales to contribute 34 percent of their total revenue over the next 12 months, down 4 points from the prior quarter. This may reflect greater domestic revenue or uncertainty about world markets, as first-quarter international sales show a continued increase: 59 percent higher, 39 percent about the same, and 2 percent decreasing – similar to fourth-quarter 2010.
- **Surge in oil/energy prices top threat.** Significantly, 65 percent of respondents cited oil/energy prices as the greatest potential barrier to own-company revenue growth over the next 12 months, rising 38 points from fourth-quarter 2010 as the cost per barrel of oil surged above $100. To add perspective, in second-quarter 2008, when the price of oil reached $145 per barrel, a survey high of 78 percent of respondents rated it as the leading barrier. The number feeling stifled by legislation/regulatory pressures dropped 14 points to 54 percent, and concern about demand plummeted 22 points to 41 percent. Concern about lack of qualified workers rose for a second quarter, up 12 points to 25 percent.
- **Costs and prices spike.** In first-quarter 2011, gross margins narrowed but remained positive: up for 37 percent and lower for 29 percent, for a net plus 8 percent. Costs were higher for 51 percent and down for only 8 percent, for a net plus 43 percent (up 32 points). And prices were higher for 43 percent and lower for 11 percent, for a net plus 32 percent (up 11 points). These quarterly rises may reflect the beginning of an inflationary trend in 2011.
- **Spending continues upward trend.** Forty-nine percent of industrial products manufacturers are planning major new investments of capital over the next 12 months. This 5-point increase from the prior quarter represents the fifth straight increase quarter over quarter and a 21-point lead over a year ago. Eighty-six percent are planning to increase operational spending, led by new product or service introductions, research and development (R&D), business acquisitions, and information technology.
- **Hiring shows stamina.** Fifty-one percent of panelists plan to add employees to their workforces over the next 12 months, up 3 points from the prior quarter and 24 points higher than a year ago. Only 3 percent plan a net reduction, and 46 percent will stay about the same. The net workforce composite projection is plus 1.3 percent, well above the 0.5 percent a year ago.

A quarter-over-quarter comparison of key indicators shows the business outlook for the next 12 months and how the views of the panel have changed each quarter (see chart 1.1). The pages that follow provide a detailed look at each question for the past five quarterly surveys.

Special topic: Significant changes and challenges in 2011

- **Significant change in year ahead.** During the last quarter of 2010, company results, next-year projections, and general economic indications prompted 85 percent of industrial products manufacturers to make significant changes in 2011 plans. These changes include increasing prices and stepping up R&D activity, new product development, hiring, and production. Yet, only 12 percent expect a major transformation or restructuring of their business within the next three years.
- **Larger cash positions.** Currently, 40 percent of respondents are maintaining a larger cash position than they typically do – 17 percent significantly larger and 23 percent a little larger. Over the next 12 to 18 months, 83 percent of those holding more cash foresee using it for acquisitions, joint ventures, increased hiring, R&D, facilities expansion, and IT projects. Seventeen percent plan to hold on to their cash.
- **Importance of tax regulations and new tax proposals.** Over the next 12 months, many tax regulations and/or new tax proposals will be important to industrial products manufacturers' profit growth. These are led by domestic manufacturing credits (40 percent), followed by extended R&D credits, foreign-source income deferrals, and limitations on foreign tax credits. Significantly, 57 percent believe that one or more of these tax deductions will likely affect own-company increased hiring over the next 12 months. The most influential deduction was domestic manufacturing credits, acknowledged by 33 percent.
- **Top challenges in 2011.** Among those surveyed, the most prominent planning issue was higher costs of goods and services, cited by 92 percent. Seventy-five percent are contemplating how they will respond to increased price flexibility, 70 percent will place a greater focus on retaining and developing talent, and 70 percent anticipate opportunities for prudent risk-taking. Other issues include greater capital spending and seizing greater opportunities for new product and service introductions. Additionally, more than half of those surveyed are looking at how they will respond to an uptick in the world economy and fears of inflation. In naming the three most important issues to own-company growth in 2011, the higher cost of goods and services landed on the most lists, cited by 35 percent. Other issues most often included in the top three were: opportunities for M&A, cited by 30 percent; fears of inflation, cited by 24 percent; and greater opportunities for new product development and improved consumer spending, both cited by 21 percent of respondents.

Key indicators for the business outlook

Chart 1.1 Key indicators for the business outlook

A quarter-over-quarter comparison of the survey's key indicators shows how the 12-month outlook has changed each quarter. The change column indicates the movement of opinion over the past two quarters.

Business outlook, next 12 months among industrial manufacturers	2010				2011	Change	Page
	1Q '10	2Q '10	3Q '10	4Q '10	1Q '11	4Q '10 – 1Q'11	
Optimistic about US economy	53%	45%	35%	63%	57%	↓	8
Optimistic about world economy	53%	38%	38%	60%	44%	↓	10
Expect positive revenue growth	75%	73%	70%	84%	89%	↑	20
Average growth rate expected	3.0%	6.0%	5.0%	6.6%	7.0%	↑	20
Planning major new investments	28%	33%	43%	44%	49%	↑	24
New investments as a % of sales	8.4%	7.0%	5.3%	5.6%	5.4%	=	24
Planning to hire	27%	47%	42%	48%	51%	=	22
New workers as a % of workforce (net)	0.5%	1.8%	0.4%	1.2%	1.3%	=	22
Expected barriers to growth							
• Oil/energy prices	30%	23%	32%	27%	65%	↑	26
• Legislative/Regulatory pressures	73%	63%	77%	68%	54%	↓	26
• Lack of demand	63%	50%	62%	63%	41%	↓	26
• Competition from foreign markets	33%	35%	43%	36%	37%	=	26
• Taxation policies	43%	57%	60%	47%	33%	↓	26
• Monetary exchange rate	37%	40%	33%	37%	29%	↓	26
• Lack of qualified workers	8%	10%	8%	13%	25%	↑	26
• Decreasing profitability	47%	35%	40%	29%	22%	↓	26
• Pressure for increased wages	13%	17%	15%	15%	21%	↑	26
• Higher interest rates	17%	13%	13%	10%	19%	↑	26
• Capital constraints	30%	23%	20%	18%	14%	↓	26

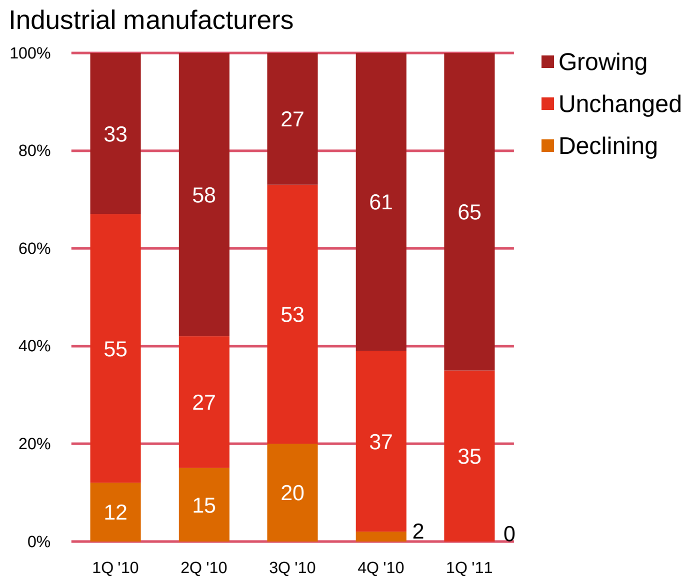
Economic views

View of the US economy, this quarter

Which best describes your view of the US economy this quarter?

In first-quarter 2011, 65 percent of panelists believed the US economy was growing, up 4 points from the prior quarter. For the first time in five years, none believed it was declining. Thirty-five percent believed the US economy did not change from fourth-quarter 2010.

Chart 2.1 View of the US economy, this quarter



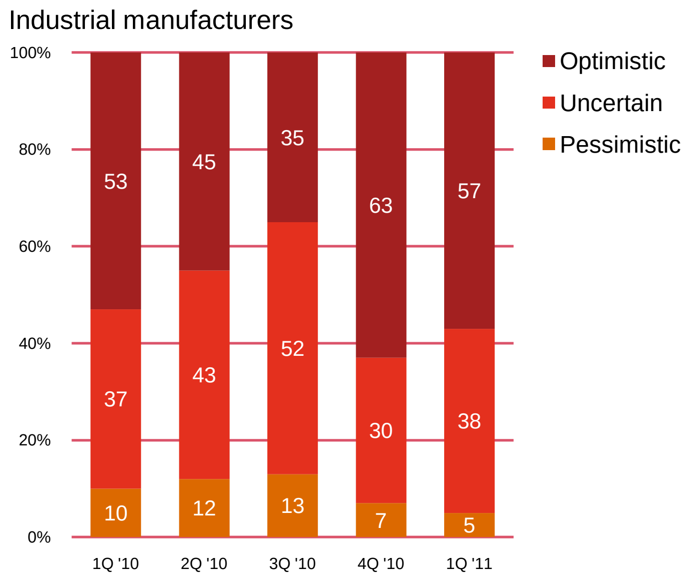
Note: In 1Q 2011 total respondents = 63

View of the US economy, next 12 months

Looking at the next 12 months, how do you feel about the prospects for the US economy?

Looking ahead, 57 percent of respondents expressed optimism about the 12-month outlook for the US economy, down only 6 points from the prior quarter's 63 percent. Only 5 percent were pessimistic, and 38 percent were uncertain.

Chart 2.2 View of the US economy, next 12 months



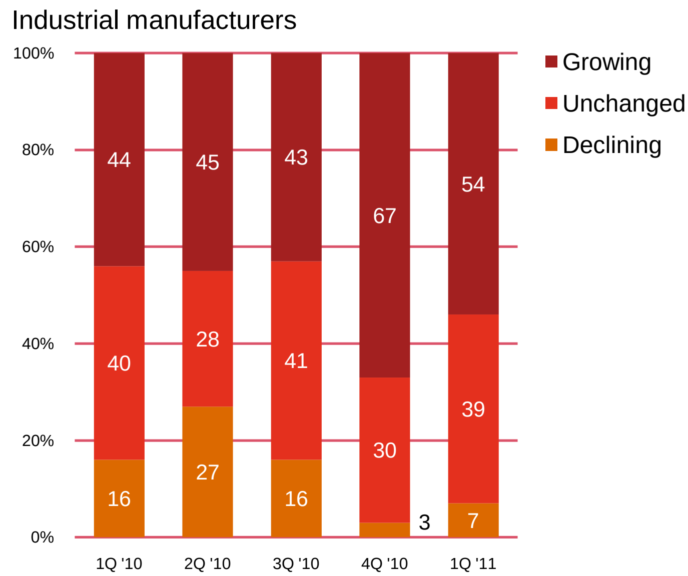
Note: In 1Q 2011 total respondents = 63

View of the world economy, this quarter

Which best describes your view of the world economy this quarter? (international marketers only)

In first-quarter 2011, 54 percent of the panelists marketing abroad viewed the world economy as growing, down 13 points from the prior quarter. Only 7 percent believed it was declining, and 39 percent felt the world economy was unchanged.

Chart 2.3 View of the world economy, this quarter



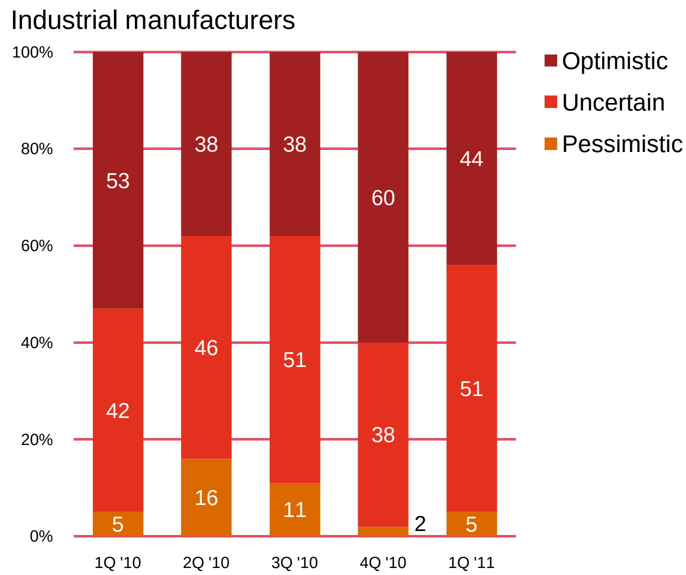
Note: In 1Q 2011 those marketing abroad = 57

View of the world economy, next 12 months

Looking at the next 12 months, how do you feel about the prospects for the world economy? (international marketers only)

Forty-four percent of US-based industrial manufacturers who market abroad are optimistic about the prospects for the world economy over the next 12 months, down 16 points from the prior quarter. The majority – 51 percent – are uncertain, and 5 percent are pessimistic.

Chart 2.4 View of the world economy, next 12 months



Note: In 1Q 2011 those marketing abroad = 57

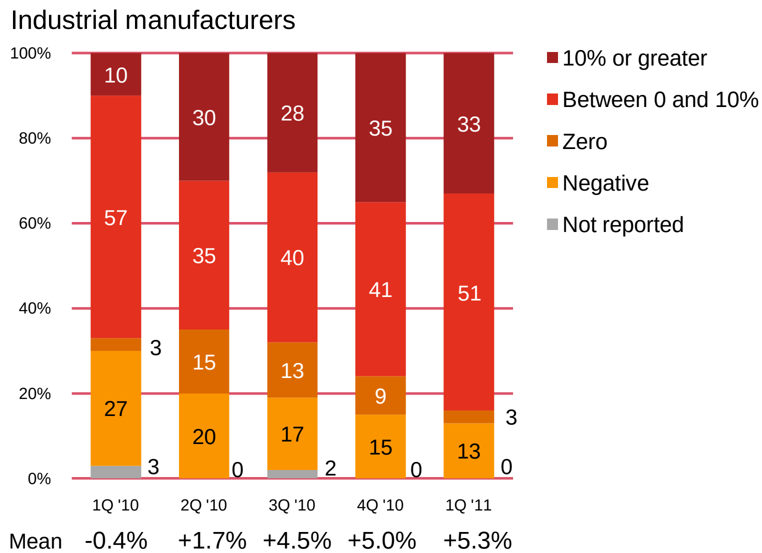
Company performance

Company revenue growth, calendar year

What is your company's estimated revenue growth rate for the calendar year?

The composite average growth estimate for own-company revenue growth in the calendar year inched up from 5.0 percent in fourth-quarter 2010 to 5.3 percent in first-quarter 2011. Eighty-four percent of respondents forecasted positive own-company growth, with 33 percent expecting double digits and 51 percent predicting single-digit growth. Thirteen percent expected to continue on the negative side, while 3 percent expected zero growth.

Chart 3.1 Company revenue growth, calendar year



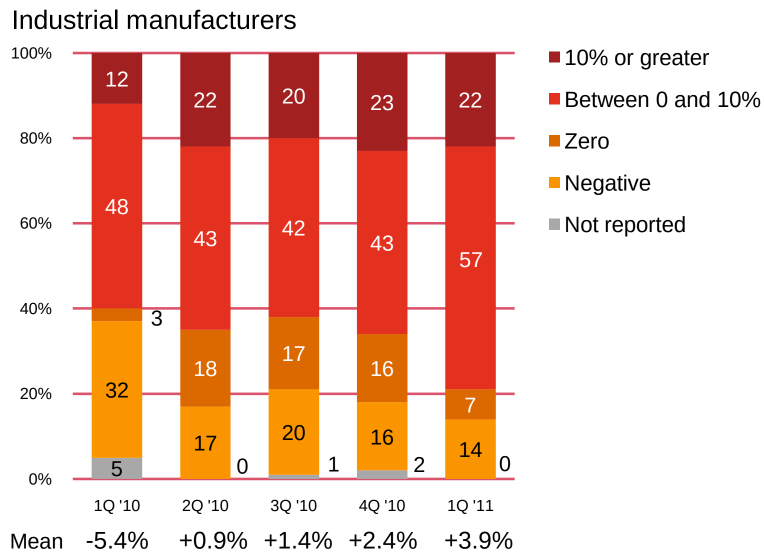
Note: In 1Q 2011 total respondents = 63

Industry growth, calendar year

What is your industry's estimated growth rate for the calendar year?

Industry growth estimates for calendar-year 2011 rose to 3.9 percent from 2.4 percent for 2010. Seventy-nine percent of panelists expect positive industry growth for 2011, 14 percent are on the negative side, and 7 percent expect zero growth.

Chart 3.2 Industry growth, calendar year



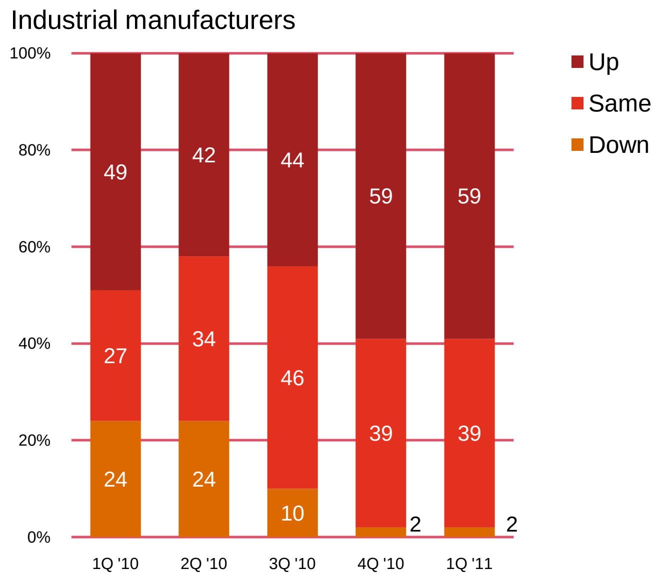
Note: In 1Q 2011 total respondents = 63

International sales

Are international sales up, down, or the same compared with three months ago? (international marketers only)

US-based industrial manufacturers that sell abroad continued to grow revenue in first-quarter 2011, with 59 percent reporting an increase in sales, and only 2 percent reporting a decrease. Thirty-nine percent remained about the same. These are identical figures to the previous quarter.

Chart 3.3 International sales



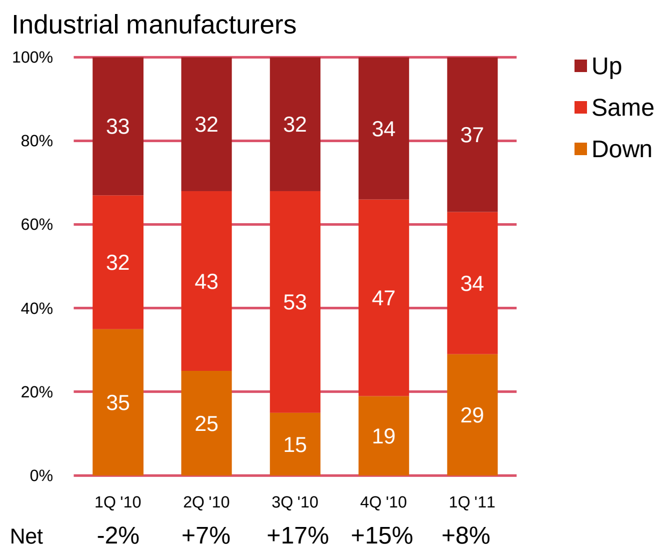
Note: In 1Q 2011 those marketing abroad = 57

Changes in gross margins

Are gross margins up, down, or the same compared with three months ago?

In first-quarter 2011, gross margins remained positive. They were higher for 37 percent of panelists and lower for 29 percent, for a net plus 8 percent, below the prior quarter's plus 15 percent.

Chart 3.4 Changes in gross margins



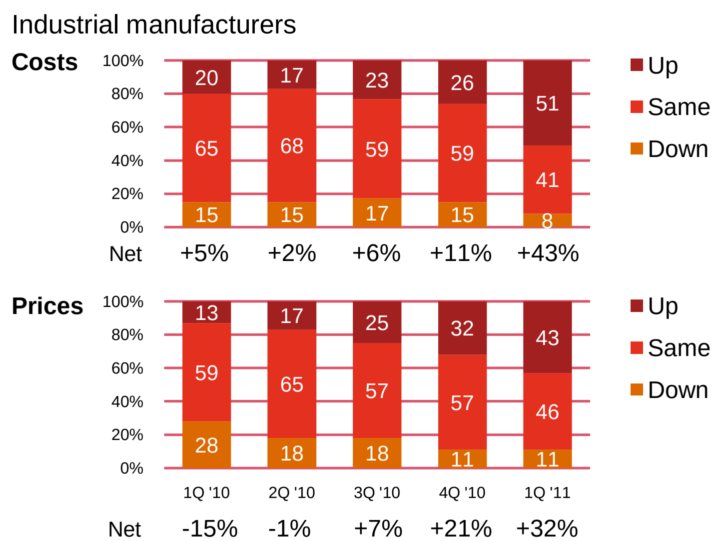
Note: In 1Q 2011 total respondents = 63

Changes in costs and prices

Are costs up, down, or the same compared with three months ago? Prices?

In first-quarter 2011, both costs and prices spiked. Fifty-one percent of US-based industrial manufacturers reported higher costs, and 8 percent reported lower costs, for a net plus 43 percent. Forty-three percent raised prices, and only 11 percent lowered them, for a net plus 32 percent.

Chart 3.5 Changes in costs and prices



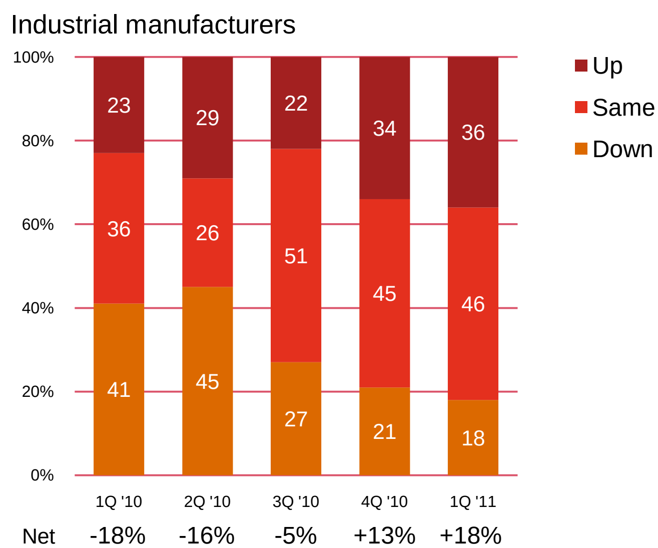
Note: In 1Q 2011 total respondents = 63

Inventory movement

Are finished inventories as a percent of sales up, down, or the same compared with three months ago?

Inventories grew for 36 percent of US-based industrial manufacturers, up 2 points on a quarter-to-quarter basis. Levels were down for 18 percent, for a net plus 18 percent, indicating some inventory replenishment in first-quarter 2011.

Chart 3.6 Inventory movement



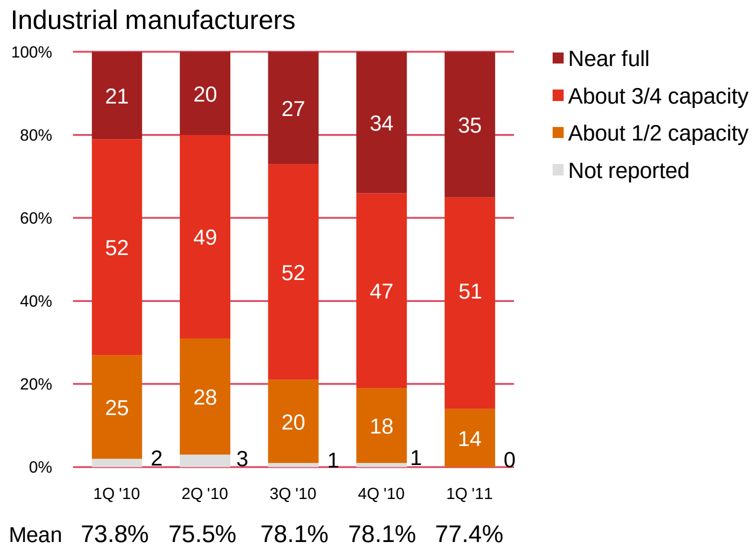
Note: In 1Q 2011 total respondents = 63

Level of operating capacity

What is your organization's current operating capacity?

Operating capacity is an estimate of the current level of permanent staffing and operations compared with what is needed for full-capacity output. For the first quarter, the mean was 77.4 percent of capacity, down slightly from the previous quarter, with 35 percent of industrial manufacturers surveyed claiming to be at or near full capacity.

Chart 3.7 Level of operating capacity



Note: In 1Q 2011 total respondents = 63

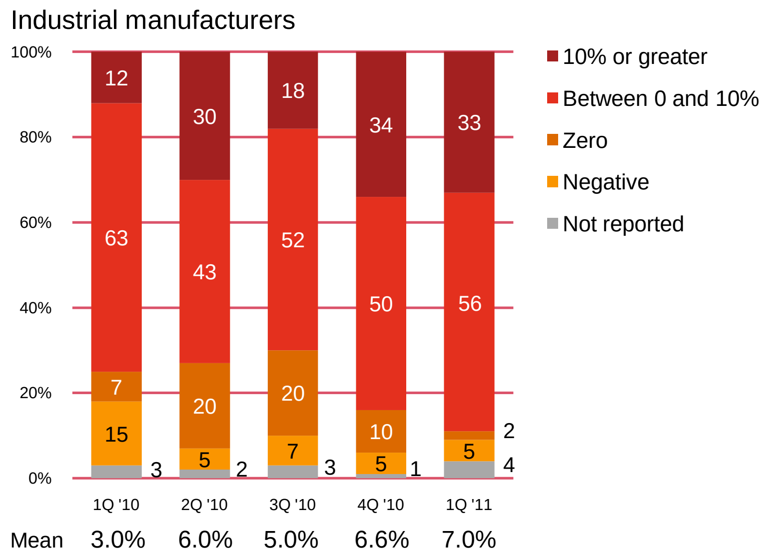
Business outlook, next 12 months

Revenue growth, next 12 months

What is your organization's estimated revenue growth rate for the next 12 months?

Looking at the next 12 months, 89 percent of panelists expect positive growth for their own companies, with 33 percent forecasting double-digit growth and 56 percent forecasting single-digit growth. The projected average growth rate rose on a quarter-to-quarter basis, from 6.6 percent to 7.0 percent. Only 5 percent forecast negative growth, 2 percent forecast zero growth, and 4 percent did not report.

Chart 4.1 Revenue growth, next 12 months



Note: In 1Q 2011 total respondents = 63

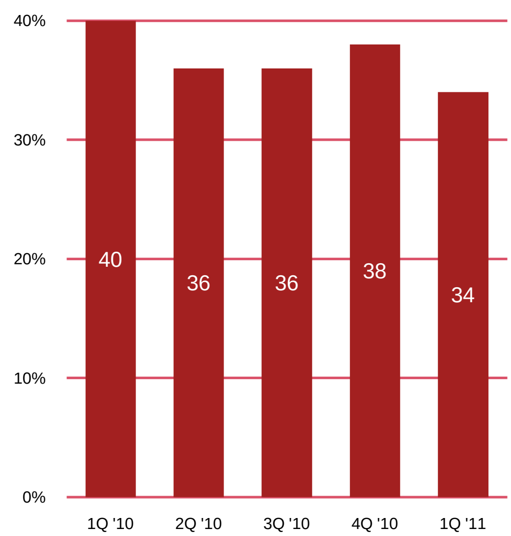
International sales, next 12 months

What percent of your business's total revenue over the next 12 months do you expect to be derived from international sales? (international marketers only)

Of respondents selling abroad, the projected contribution of international sales to total revenue over the next 12 months dropped to 34 percent from the prior quarter's 38 percent.

Chart 4.2 International sales, next 12 months

Industrial manufacturers



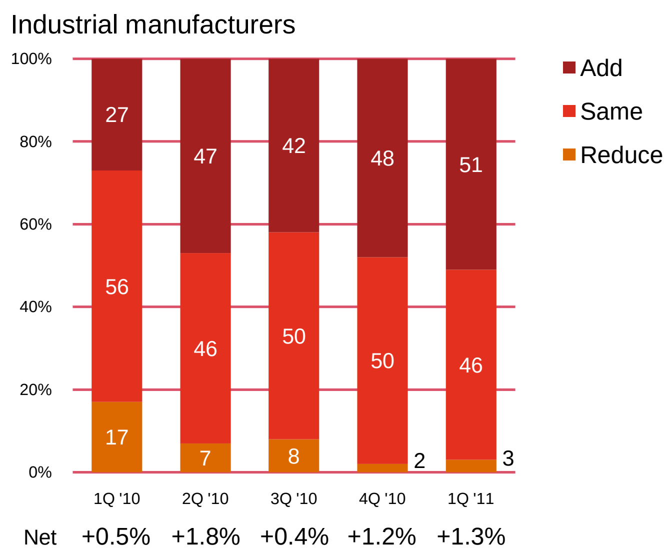
Note: In 1Q 2011 those marketing abroad = 57

Percent planning to hire

Do you plan to add or reduce the number of full-time equivalent employees over the next 12 months?

Fifty-one percent of respondents plan to add employees to their workforce over the next 12 months, up 3 points from fourth-quarter 2010. Only 3 percent plan to reduce the number of full-time equivalent employees, and 46 percent will stay about the same. The net workforce projection is plus 1.3 percent, up slightly from last quarter's 1.2 percent, a sign of moderate new hiring growth.

Chart 4.3 Percent planning to hire



Note: In 1Q 2011 total respondents = 63

Percent planning to hire by type of employee

What types of employees do you plan to add over the next 12 months?

Among the 51 percent of respondents planning to hire within the next 12 months, the most sought-after employees will be professionals/technicians, along with skilled labor and production workers.

Chart 4.4 Percent planning to hire by type of employee

Industrial manufacturers

	1Q '10	2Q '10	3Q '10	4Q '10	1Q '11
Planning to hire (net)	27%	47%	42%	48%	51%
• Professionals/technicians	17%	25%	22%	27%	35%
• Skilled labor	2%	23%	23%	23%	30%
• Production workers	13%	27%	28%	18%	27%
• White collar support	10%	17%	15%	18%	18%
• Sales/marketing	8%	15%	17%	15%	8%

Note: In 1Q 2011 total respondents = 63

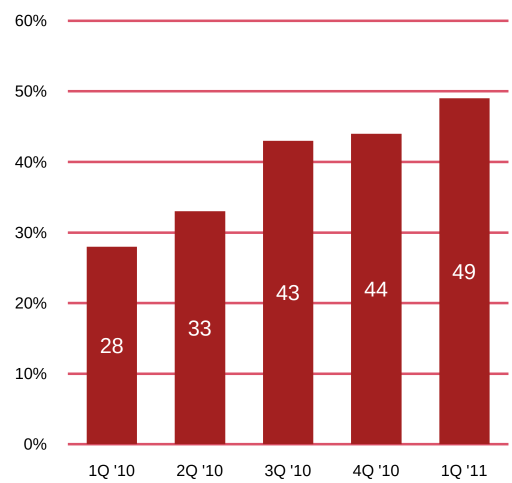
Percent planning major new investments of capital

Are you actively planning any major new investments of capital over the next 12 months? If so, what percent of total sales do you expect to invest?

Forty-nine percent of industrial products manufacturers surveyed plan major new investments of capital during the next 12 months, a 5-point increase over the prior quarter. The mean investment as a percentage of total sales was similar to the prior quarter, at 5.4 percent.

Chart 4.5 Percent planning major new investments of capital

Industrial manufacturers



Mean investment as a % of total sales	8.4%	7.0%	5.3%	5.6%	5.4%

Note: In 1Q 2011 total respondents = 63

Percent planning to increase operational spending

Over the next 12 months, where do you expect to increase spending?

Looking at the next 12 months, 86 percent of respondents plan to increase operational spending, up 4 points from last quarter. Leading increased expenditures were new product or service introductions, R&D, business acquisitions and information technology. Geographic expansion dropped 9 points to 33 percent, and facilities expansion dipped 3 points to 29 percent.

Chart 4.6 Percent planning to increase operational spending

Industrial manufacturers

	1Q '10	2Q '10	3Q '10	4Q '10	1Q '11
Percent planning to increase spending (net)	70%	80%	85%	82%	86%
• New product or service introduction	43%	52%	47%	50%	49%
• Research and development	28%	32%	42%	45%	46%
• Business acquisition	23%	38%	43%	39%	41%
• Information technology	20%	22%	28%	34%	41%
• Geographic expansion	22%	28%	33%	42%	33%
• Facilities expansion	20%	23%	27%	32%	29%
• Marketing & sales promotion	13%	13%	12%	15%	22%
• Advertising	12%	5%	7%	5%	14%
• Internet commerce	5%	7%	3%	11%	5%

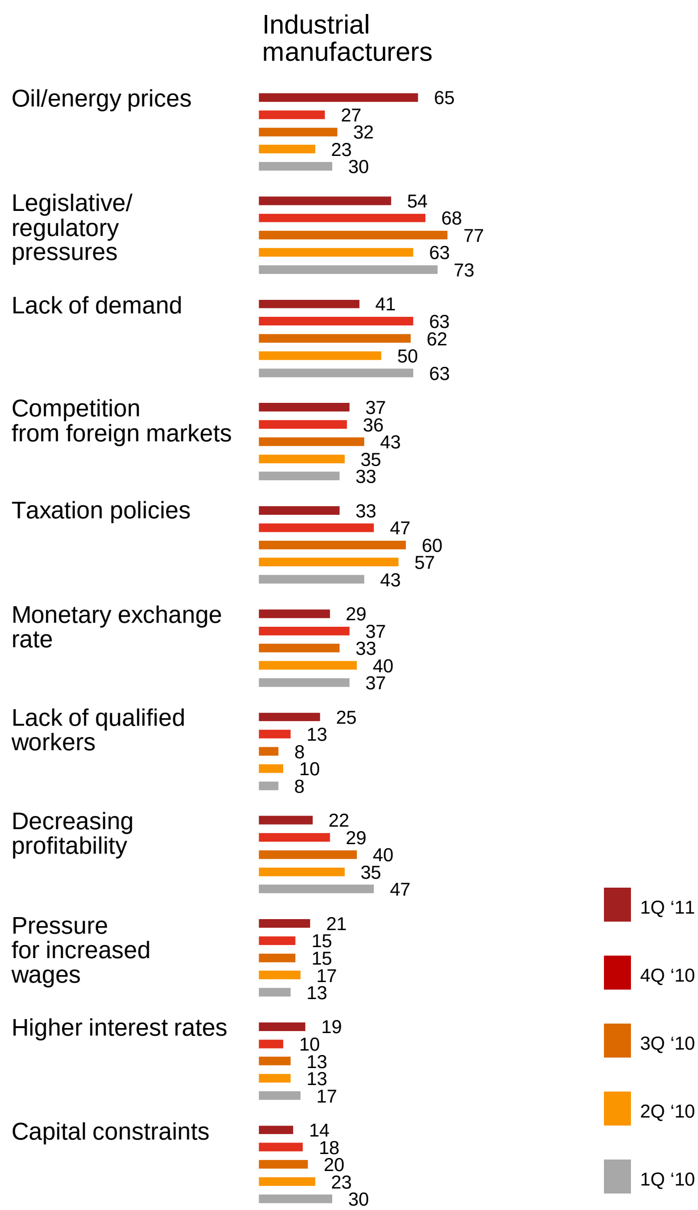
Note: In 1Q 2011 total respondents = 63

Expected barriers to business growth

Over the next 12 months, will any of the following represent barriers to business growth?

Concern over oil/energy prices rose 38 points to 65 percent and now tops the list of barriers to growth over the next 12 months. Legislative/regulatory pressures came in second, with 54 percent expressing concern. Although down significantly from the prior quarter, lack of demand was the third-biggest threat, cited by 41 percent. Concern about taxation policies dropped 14 points to 33 percent. Respondents showed increased concern for lack of qualified workers, climbing 12 points from the prior quarter to 25 percent.

Chart 4.7 Expected barriers to business growth



Note: In 1Q 2011 total respondents = 63

Plans for M&A and other business initiatives

Over the next 12 months, do you expect to participate in any of the following new business initiatives?

The number of respondents planning M&A activity over the next 12 months climbed 2 points to 41 percent. Of that number, most are looking at purchasing another business (38 percent). Plans for expansion to new markets abroad was at 33 percent while plans for new facilities abroad was at 22 percent. New strategic alliances rose 7 points to 41 percent, and joint ventures rose to 32 percent.

Chart 4.8 Plans for M&A and other business initiatives

Industrial manufacturers

	1Q '10	2Q '10	3Q '10	4Q '10	1Q '11
New business initiatives (net)	60%	55%	65%	66%	64%
• M&A activity (net)	37%	33%	38%	39%	41%
- Purchase another business	33%	33%	37%	36%	38%
- Sale part/all own business	8%	7%	8%	10%	6%
- Equity carve-out/spin-off	3%	2%	2%	2%	2%
• New strategic alliance	33%	32%	37%	34%	41%
• Expand to new markets abroad	28%	27%	30%	37%	33%
• New joint venture	27%	30%	33%	29%	32%
• New facilities abroad	15%	20%	18%	27%	22%
• Reduce activity in markets abroad	10%	7%	8%	7%	8%
• Close/reduce facilities abroad	8%	5%	7%	7%	6%

Note: In 1Q 2011 total respondents = 63

Special topic: Significant changes and challenges in 2011

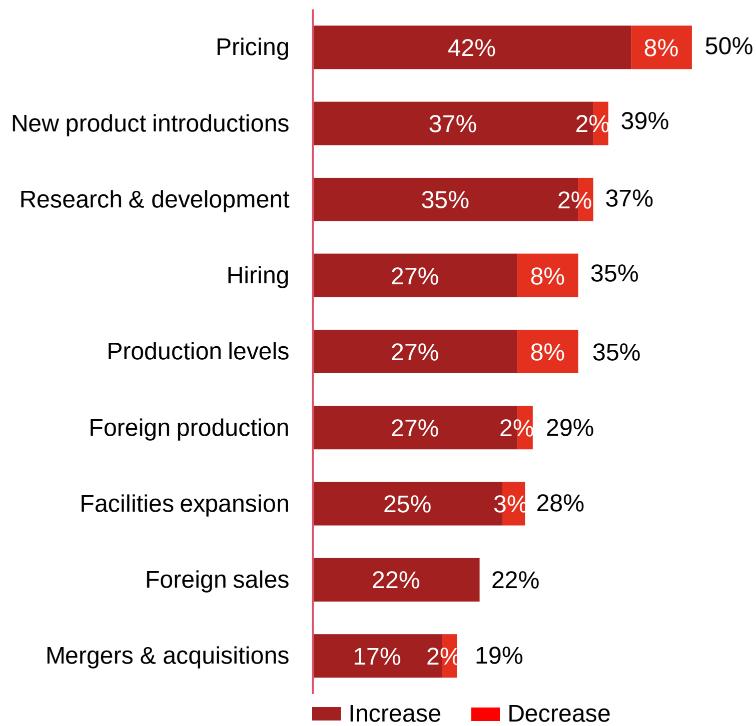
Significant changes in business strategies/plans

During the last quarter of 2010, did your year-end results, next-year projections, or general economic indications (e.g., GDP, employment trends, increased orders, etc.) prompt your company to make significant changes in its plans for 2011? If so, are you planning increases or decreases in these areas?

Eighty-five percent of respondents were prompted to make significant changes in 2011 plans. These changes included increasing prices and stepping up new product introductions, R&D, hiring, and production levels.

Yet, within the next three years, only 12 percent expect a significant change in the business environment that may necessitate a major transformation or restructuring of their business.

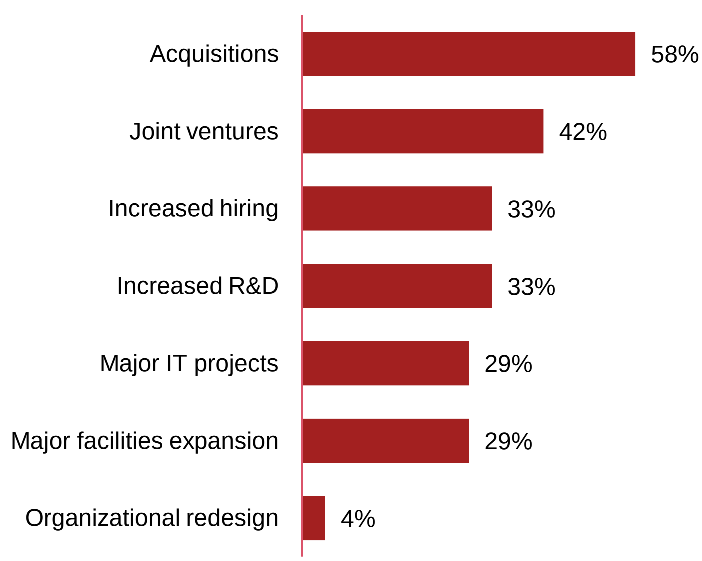
Chart 5.1 Increases and decreases in 2011 plans



Most companies are now maintaining a larger cash position than they typically do. Is that the case for your company? Over the next 12-18 months, do you foresee utilizing that cash? How?

Currently, 40 percent of panelists are maintaining a larger cash position than they typically do – 17 percent significantly larger and 23 percent a little larger. Over the next 12 to 18 months, 58 percent of those with a larger cash position foresee using that cash for acquisitions, 42 percent will use it to enter into joint ventures, 33 percent will increase hiring, and 33 percent will step up R&D. Only 17 percent said they will continue to hold on to their cash.

Chart 5.2 Using larger cash positions within 12-18 months

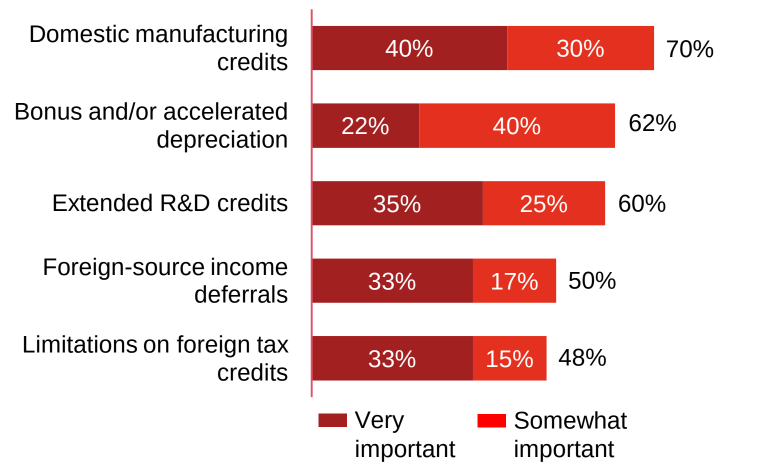


Importance of tax regulations and new tax proposals

How important do you believe the following tax regulations and/or new proposals will be to your own company's profit growth over the next 12 months? Will they be very important, somewhat important, or not particularly important?

Over the next 12 months, many tax regulations and/or new tax proposals will be an important factor in industrial manufacturers' profit growth. Seventy percent of respondents said domestic manufacturing credits will be very or somewhat important, followed by bonus and/or accelerated depreciation, extended R&D credits, foreign-source income deferrals, and limitations on foreign tax credits.

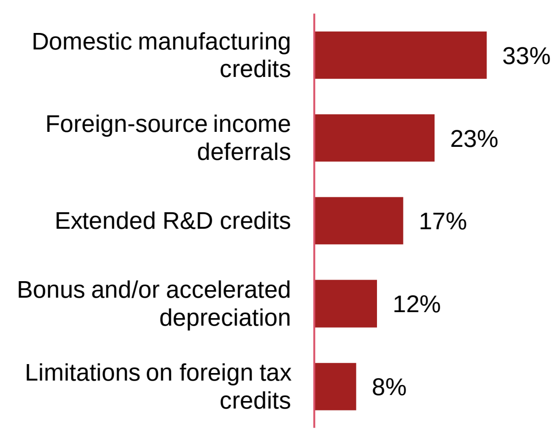
Chart 5.3 Importance to company growth over the next 12 months



Which of these deductions, if any, is likely to influence your company's hiring decisions over the next 12 months?

Significantly, 57 percent of industrial manufacturers surveyed believe that one or more of these tax deductions will likely influence their hiring decisions over the next 12 months. The most influential deduction regarding hiring was domestic manufacturing credits, cited by 33 percent.

Chart 5.4 Influence on domestic hiring over the next 12 months

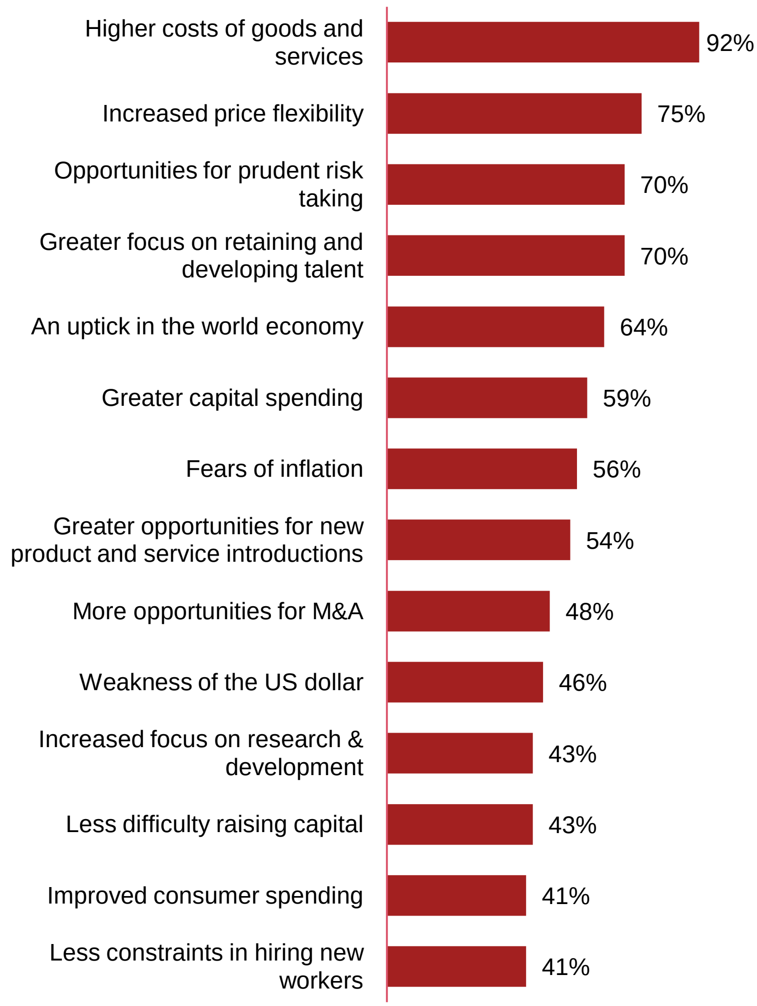


Top challenges in planning for 2011

What issues are most prominent in your company's planning process for 2011?

Most industrial manufacturers are actively planning for higher costs of goods and services in 2011, cited by 92 percent. Three other issues dominating respondents' plans include: increased price flexibility (75 percent); opportunities for prudent risk taking (70 percent); and greater focus on retaining and developing talent (70 percent). In listing the top 3 challenges that will affect own-company growth in 2011, the most respondents cited higher costs of goods and services, followed by more opportunities for M&A and fears of inflation.

Chart 5.5 Planning challenges for 2011



Survey demographics and research methodology

Demographics

Who	Senior executives of US-based, industrial manufacturing organizations
Interview dates	January 6, 2011 to April 4, 2011
	Industrial manufacturers (63)
Average number of employees	8,067
Average business unit revenue	$2.85 billion
Average enterprise revenue	$10.16 billion
Market capitalization	$13.29 billion
Industry sectors	Products 100% Manufacturing 100%

Methodology

PwC's Manufacturing Barometer is a quarterly telephone survey conducted by the independent research firm BSI Global Research Inc. Our regular survey panel consists of senior executives from a geographically balanced sample of large companies in the United States. Ninety-five percent of the panelists hold titles such as president, CEO, CFO, VP of finance, treasurer, controller, internal audit director or other related title.

www.pwc.com/manufacturing

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About the research:

The Manufacturing Barometer is one in a series of quarterly business outlook surveys from PwC. The survey provides a view on the 12-month outlook for revenue growth, new investments, new hiring plans, emerging business barriers and more. In addition to the business outlook, we hear from our panelists about special issues they face as the business climate changes. Results of the quarterly business outlook surveys and special issue surveys are available at www.barometersurveys.com.

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