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Manufacturing Barometer

Business outlook report
January 2011

Contents

Quarterly highlights

In the fourth quarter of 2010, PwC interviewed 62 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, we saw an upswing in optimism about the US and world economies' prospects, with stronger own-company revenue forecasts and improving international revenue contributions. Early signs of new hiring and price flexibility emerged.

Key findings:

- **A swell of optimism.** Looking at the next 12 months, 63 percent of industrial products manufacturers are optimistic about the US economy's prospects, 28 points up from the prior quarter's 35 percent and 16 points up from last year's 47 percent. Only 7 percent remain pessimistic, and 30 percent are uncertain. The number optimistic about the world economy over the next 12 months also advanced sharply among those marketing abroad, rising 22 points to 60 percent. Only 2 percent are pessimistic, and 38 percent remain uncertain.
- **Revenue projections strengthen.** The projected average growth rate for own-company revenue over the next 12 months rose from 5 percent in the prior quarter to 6.6 percent in fourth-quarter 2010. This rate is more than double the 2.7 percent growth rate reported a year ago. Eighty-four percent expect positive revenue growth for their own companies in the year ahead, with 34 percent forecasting double-digit growth and 50 percent single-digit growth. Only 5 percent forecast negative growth, 10 percent zero growth, and 1 percent did not respond to the survey question.
- **Costs and prices rising.** In fourth-quarter 2010, gross margins were up for 34 percent and down for 19 percent, for a net plus 15 percent, similar to last quarter. Net costs were up for 26 percent and lower for 15 percent, for a net plus 11 percent (up 5 points). Notable increases were reported for prices: up for 32 percent and down for 11 percent, for a net plus 21 percent (up 14 points). This suggests some price flexibility not seen in the past several quarters.
- **International sales solid and gaining.** Respondents marketing abroad expect international sales to contribute 38 percent of their total revenue over the next 12 months, up 2 points from the prior quarter and up 4 points from a year ago. In fourth-quarter 2010, 59 percent reported an increase in sales abroad, 39 percent said sales were about the same, and only 2 percent reported a decrease.
- **Job outlook stabilizes.** Over the next 12 months, 48 percent of panelists plan to add employees to their workforces, up 6 points from 42 percent last quarter and up 18 points from last year's 30 percent. Only 2 percent are net reducing, while 50 percent plan to stay about the same. The net workforce projection is plus 1.2 percent over the next 12 months, up from 0.4 percent both last quarter and a year ago.
- **Spending plans continue.** Forty-four percent of industrial products manufacturers surveyed are planning major new investments of capital over the next 12 months, up 1 point from the prior quarter, but 9 points higher than a year ago. On average, they plan to spend a mean investment of 5.6 percent of sales, similar to the prior quarter but a point higher than a year ago. Eighty-two percent are planning increases in operational or budget spending, led by increases in new product or service introductions and R&D.
- **Regulatory pressure, tax law, low profitability concern fewer.** In the fourth quarter, the number of respondents concerned about demand inched up one point to 63 percent, but three other potential barriers to business growth over the next 12 months were mentioned less. Legislation/regulatory pressures, the highest ranked barrier, fell 9 points to 68 percent; concern about taxation dipped 13 points to 47 percent; and concern about decreasing profitability declined 11 points to 29 percent. In contrast, concern about lack of qualified workers rose 5 points, but remains low, at 13 percent.

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: Corporate reputation and the impact of issues on business operations

In today's complex, global business environment, the importance of maintaining the trust of important stakeholders, including customers, employees, shareholders, and the public, is a concern of every company. In addition, accounting standard changes, environmental concerns, data security, and contract compliance may impact how businesses will operate over the next few years.

- **Maintaining stakeholders' trust.** Eighty-one percent of respondents who answered the survey's special topic questions said corporate reputation is a top 10 priority to maintain trust with their stakeholders, and 55 percent said it is among their top 5 priorities.

  The majority (52 percent) feel trust of major stakeholders is more important now than it has been within the past two to three years; none thinks it is less important. Customers ranked first among stakeholder groups that will be of increasing importance to corporations over the next three to five years in maintaining reputation and trust. They were followed by shareholders and employees. One-third ranked all equally important.

- **Third-party verification and certification.** Within the next two years, 81 percent of respondents expect to obtain some type of third-party verification or certification, demonstrating their importance.

  The majority plan to obtain third-party verification or certification in corporate responsibility and information security. Of those who don't, more than half said either they do not see a need for it or that is not cost-effective.

- **Impact on how business operates over the next 3-5 years.** Ninety-seven percent of respondents said changes to FASB and IASB accounting standards will influence how their business operates within the next three to five years, with 73 percent saying the changes will have a major or moderate impact. Other high-ranking issues expected to have a major or moderate impact include environmental regulations (65 percent) and information security (53 percent).

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	2009	2010				Change	Page
	4Q '09	1Q '10	2Q '10	3Q '10	4Q '10	3Q – 4Q '10	
Optimistic about US economy	47%	53%	45%	35%	63%	↑	8
Optimistic about world economy	41%	53%	38%	38%	60%	↑	10
Expect positive revenue growth	57%	75%	73%	70%	84%	↑	20
Average growth rate expected	2.7%	3.0%	6.0%	5.0%	6.6%	↑	20
Planning major new investments	35%	28%	33%	43%	44%	=	24
New investments as a % of sales	4.6%	8.4%	7.0%	5.3%	5.6%	=	24
Planning to hire	30%	27%	47%	42%	48%	↑	22
New workers as a % of workforce (net)	0.4%	0.5%	1.8%	0.4%	1.2%	↑	22
Expected barriers to growth							
• Legislative/Regulatory pressures	52%	73%	63%	77%	68%	↓	26
• Lack of demand	75%	63%	50%	62%	63%	=	26
• Taxation policies	53%	43%	57%	60%	47%	↓	26
• Monetary exchange rate	22%	37%	40%	33%	37%	↑	26
• Competition from foreign markets	37%	33%	35%	43%	36%	↓	26
• Decreasing profitability	42%	47%	35%	40%	29%	↓	26
• Oil/energy prices	33%	30%	23%	32%	27%	↓	26
• Capital constraints	22%	30%	23%	20%	18%	=	26
• Pressure for increased wages	13%	13%	17%	15%	15%	=	26
• Lack of qualified workers	3%	8%	10%	8%	13%	↑	26
• Higher interest rates	17%	17%	13%	13%	10%	↓	26

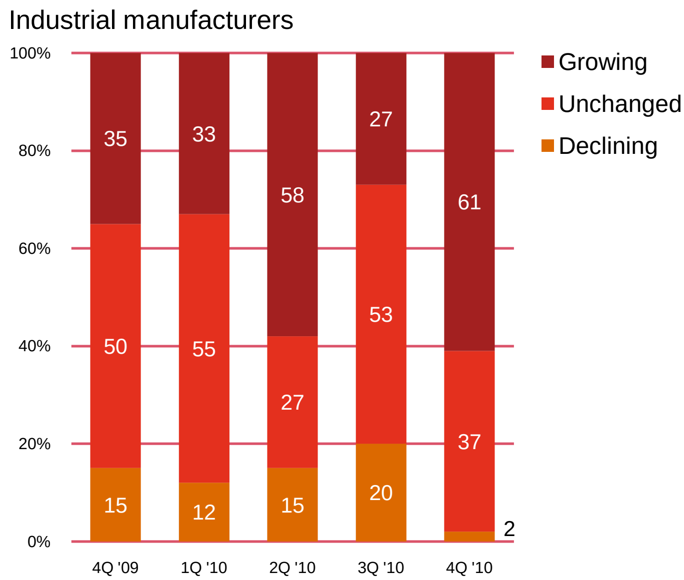
Economic views

View of the US economy, this quarter

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

In fourth-quarter 2010, 61 percent of panelists believed the US economy was growing, up 34 points from the prior quarter. Only 2 percent believed it was declining. Thirty-seven percent believed the US economy did not change from third-quarter 2010.

Chart 2.1 View of the US economy, this quarter



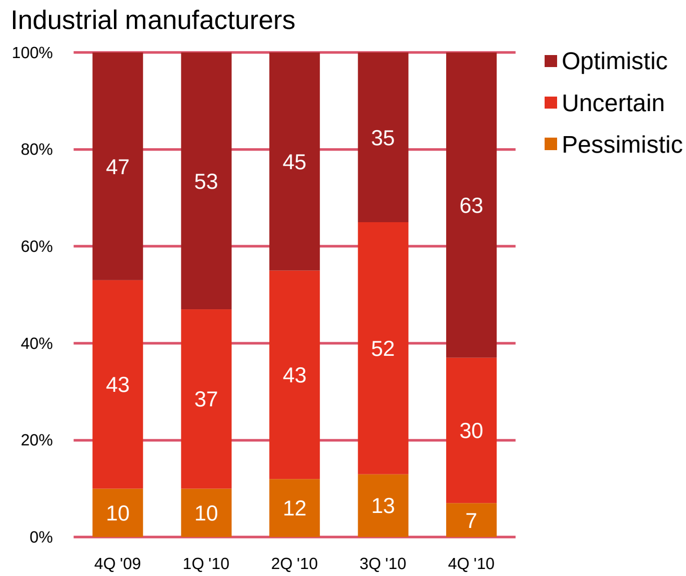
Note: In 4Q 2010 total respondents = 62

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, 63 percent of respondents expressed optimism about the 12-month outlook for the US economy, up 28 points from the prior quarter. Only 7 percent were pessimistic, and 30 percent were uncertain.

Chart 2.2 View of the US economy, next 12 months



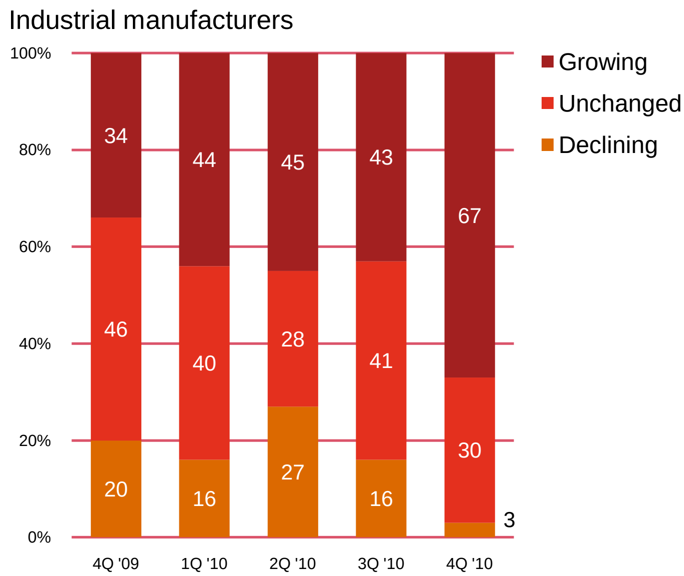
Note: In 4Q 2010 total respondents = 62

View of the world economy, this quarter

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

In fourth-quarter 2010, 67 percent of the panelists marketing abroad viewed the world economy as growing, up 24 points from the prior quarter. Only 3 percent believed it was declining, and 30 percent felt the world economy was unchanged.

Chart 2.3 View of the world economy, this quarter



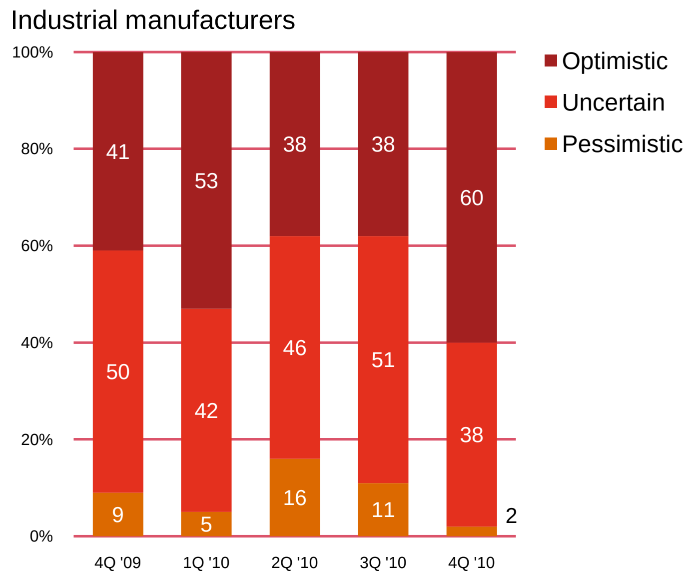
Note: In 4Q 2010 those marketing abroad = 58

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)

Sixty percent of US-based industrial manufacturers who market abroad are optimistic about the prospects for the world economy over the next 12 months, up 22 points from the prior quarter. Thirty-eight percent are uncertain, and 2 percent are pessimistic.

Chart 2.4 View of the world economy, next 12 months



Note: In 4Q 2010 those marketing abroad = 58

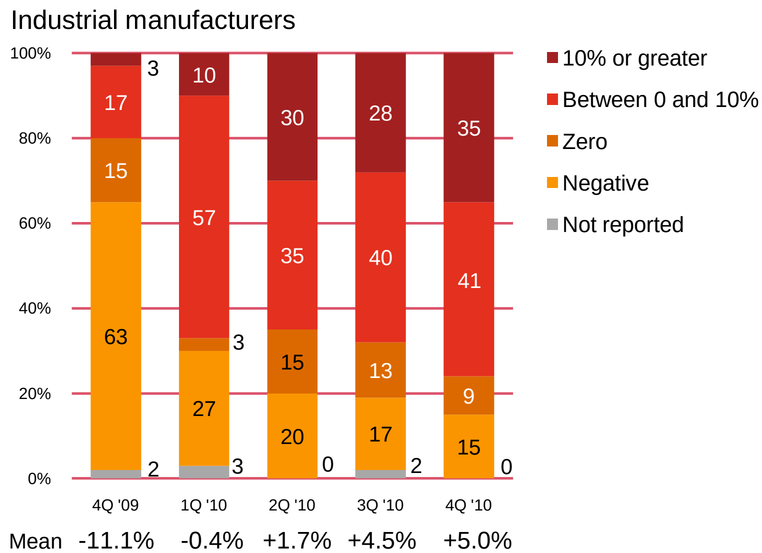
Company performance

Company revenue growth, calendar year

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

The composite average growth estimate for the calendar year rose, from 4.5 percent in the prior quarter to a final 5 percent in the fourth quarter. Seventy-six percent of respondents forecasted positive own-company growth, with 35 percent expecting double digits and 41 percent predicting single-digit growth. Fifteen percent expected to continue on the negative side, while 9 percent expected zero growth.

Chart 3.1 Company revenue growth, calendar year



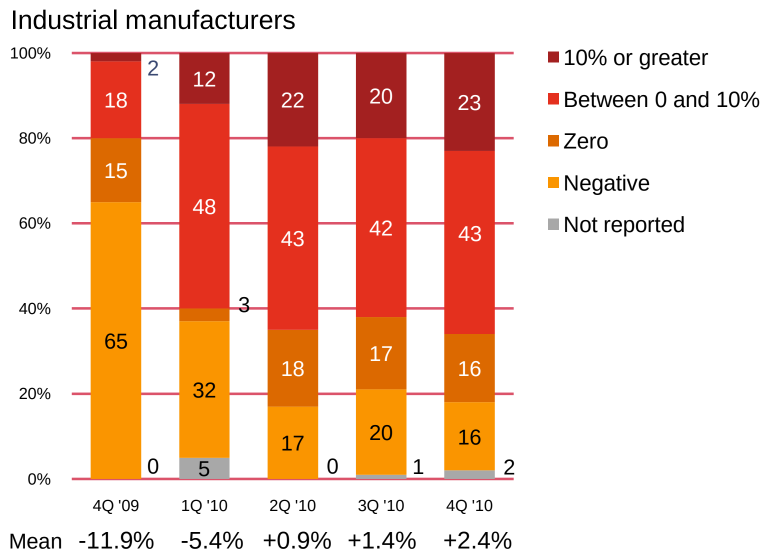
Note: In 4Q 2010 total respondents = 62

Industry growth, calendar year

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

Industry growth estimates for calendar year 2010 rose from 1.4 percent in the prior quarter to a final 2.4 percent for the year. Sixty-six percent of panelists expected positive industry growth for 2010, 16 percent were on the negative side, 16 percent expected zero growth, and 2 percent did not respond to the survey question.

Chart 3.2 Industry growth, calendar year



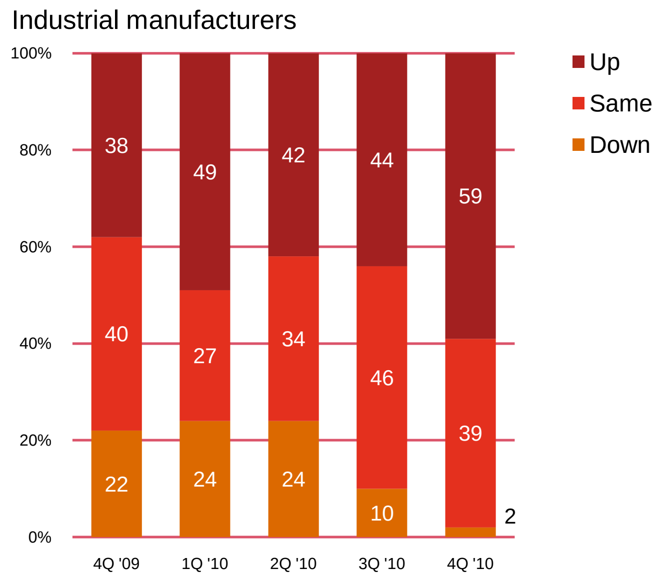
Note: In 4Q 2010 total respondents = 62

International sales

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

For US-based industrial manufacturers that sell abroad, international markets showed notable improvement in fourth-quarter 2010, with 59 percent reporting an increase in sales, up 15 points quarter-to-quarter. Only 2 percent reported a decrease, and 39 percent remained about the same.

Chart 3.3 International sales



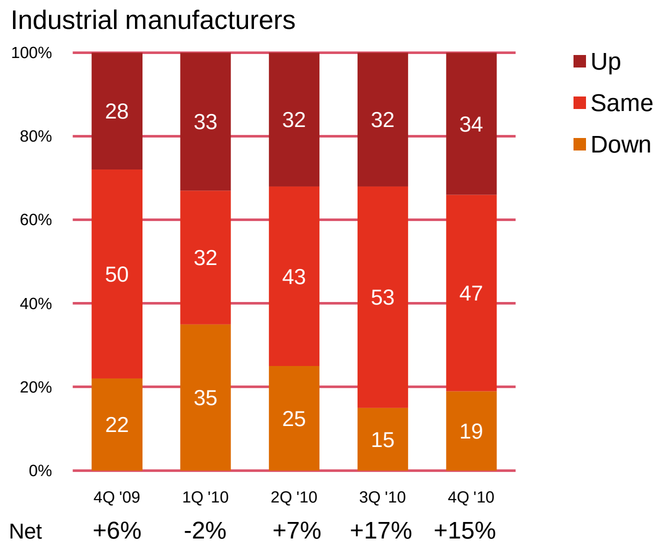
Note: In 4Q 2010 those marketing abroad = 58

Changes in gross margins

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

In fourth-quarter 2010, gross margins remained positive. They were higher for 34 percent of panelists and lower for 19 percent, for a net plus 15 percent, similar to the prior quarter's plus 17 percent.

Chart 3.4 Changes in gross margins



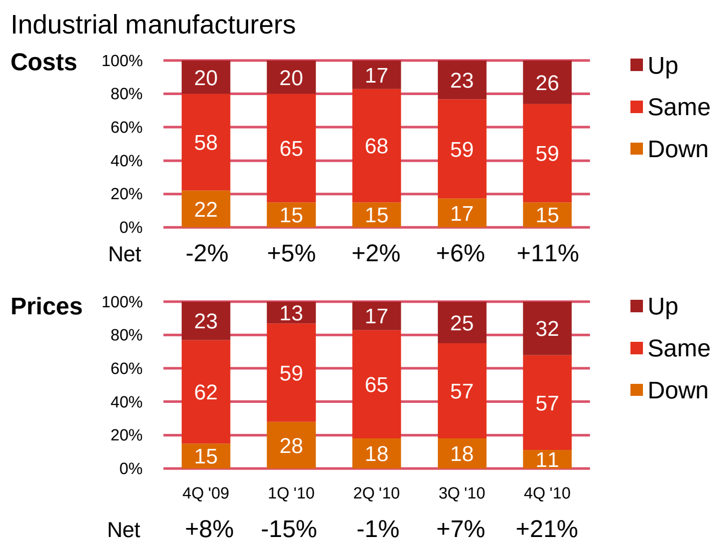
Note: In 4Q 2010 total respondents = 62

Changes in costs and prices

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

In fourth-quarter 2010, costs and prices were on the rise. Twenty-six percent of US-based industrial manufacturers reported higher costs, and 15 percent reported lower costs, for a net plus 11 percent. Thirty-two percent raised prices, and only 11 percent lowered them, for a net plus 21 percent – the first strong sign of pricing increases during recent years.

Chart 3.5 Changes in costs and prices



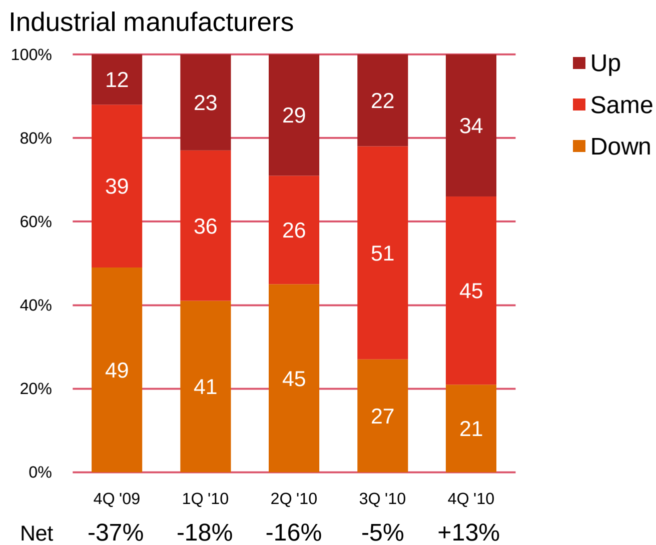
Note: In 4Q 2010 total respondents = 62

Inventory movement

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

Inventories surged for 34 percent of US-based industrial manufacturers, up 12 points on a quarter-to-quarter basis. It was down for 21 percent, for a net plus 13 percent, indicating some inventory replenishment in fourth-quarter 2010 and the first positive movement in over a year.

Chart 3.6 Inventory movement



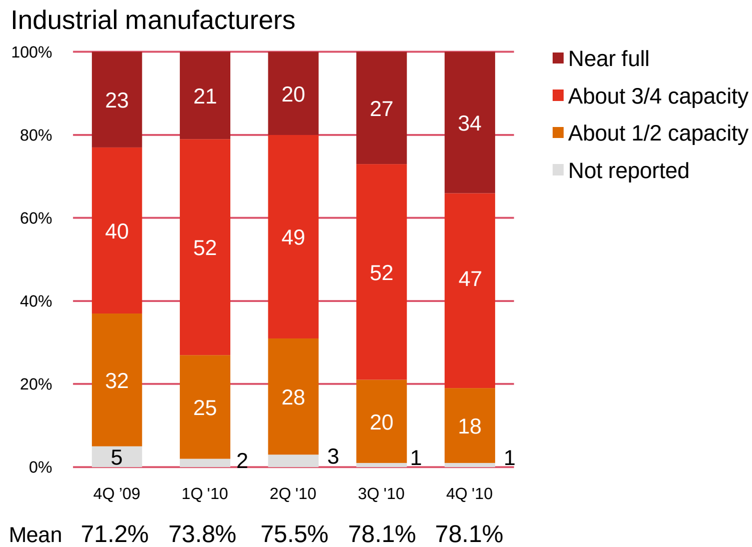
Note: In 4Q 2010 total respondents = 62

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 fourth quarter, the mean was 78.1 percent of capacity, the same as the previous quarter, with 34 percent of industrial manufacturers surveyed claiming to be at or near full capacity (up 7 points).

Chart 3.7 Level of operating capacity



Note: In 4Q 2010 total respondents = 62

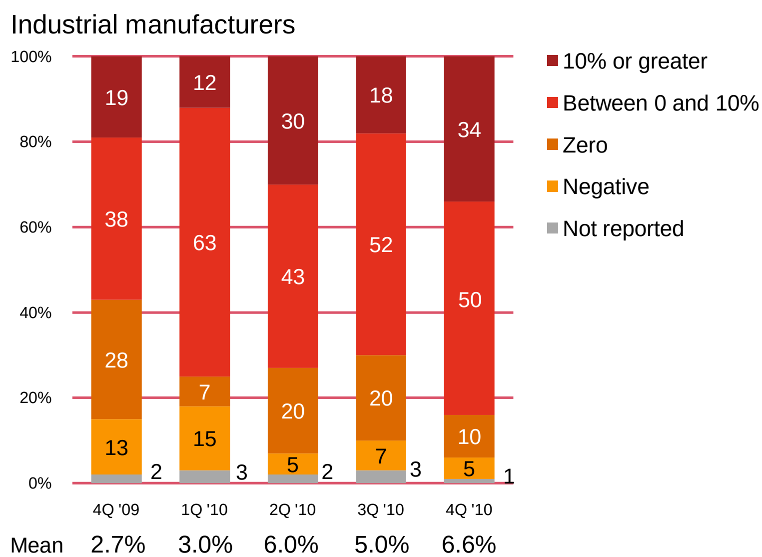
Business outlook, next 12 months

Revenue growth, next 12 months

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

Looking ahead at the next 12 months, 84 percent of panelists expect positive growth for their own companies, with 34 percent forecasting double-digit growth and 50 percent forecasting single-digit growth. The projected average growth rate rose sharply on a quarter-to-quarter basis, from 5 percent to 6.6 percent. Only 5 percent forecast negative growth, 10 percent forecast zero growth, and 1 percent did not report.

Chart 4.1 Revenue growth, next 12 months



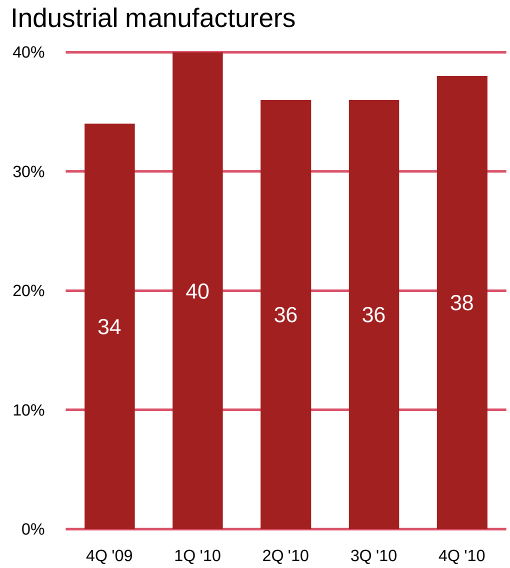
Note: In 4Q 2010 total respondents = 62

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 rose to 38 percent, up 2 points from the prior quarter.

Chart 4.2 International sales, next 12 months



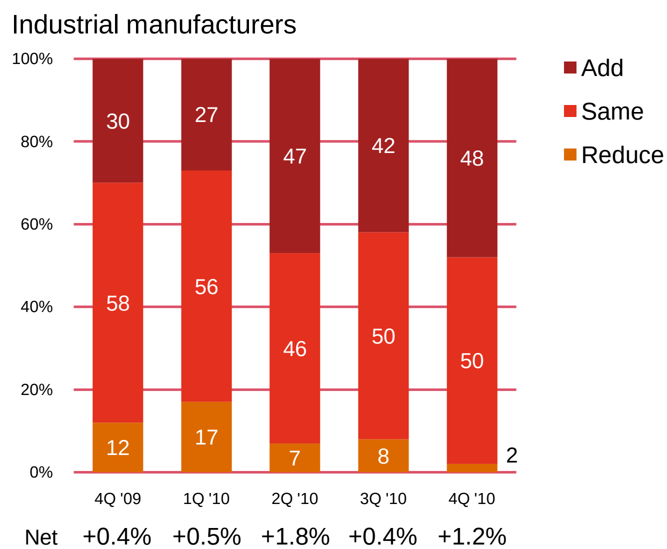
Note: In 4Q 2010 those marketing abroad = 58

Percent planning to hire

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

Forty-eight percent of respondents plan to add employees to their workforces over the next 12 months, up 6 points from the third quarter. Only 2 percent plan to reduce the number of full-time equivalent employees, and 50 percent will stay about the same. The net workforce projection is plus 1.2 percent, up from last quarter's 0.4 percent, a sign of moderate new hiring growth.

Chart 4.3 Percent planning to hire



Note: In 4Q 2010 total respondents = 62

Percent planning to hire by type of employee

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

Among the 48 percent of respondents planning to hire within the next 12 months, the most sought-after employees will be professionals/technicians, along with skilled labor. Just 18 percent of those planning to hire expect to add production workers, a drop of 10 points from the third quarter.

Chart 4.4 Percent planning to hire by type of employee

Industrial manufacturers

	4Q '09	1Q '10	2Q '10	3Q '10	4Q '10
Planning to hire (net)	30%	27%	47%	42%	48%
• Professionals/technicians	23%	17%	25%	22%	27%
• Skilled labor	12%	2%	23%	23%	23%
• White collar support	2%	10%	17%	15%	18%
• Production workers	13%	13%	27%	28%	18%
• Sales/marketing	7%	8%	15%	17%	15%

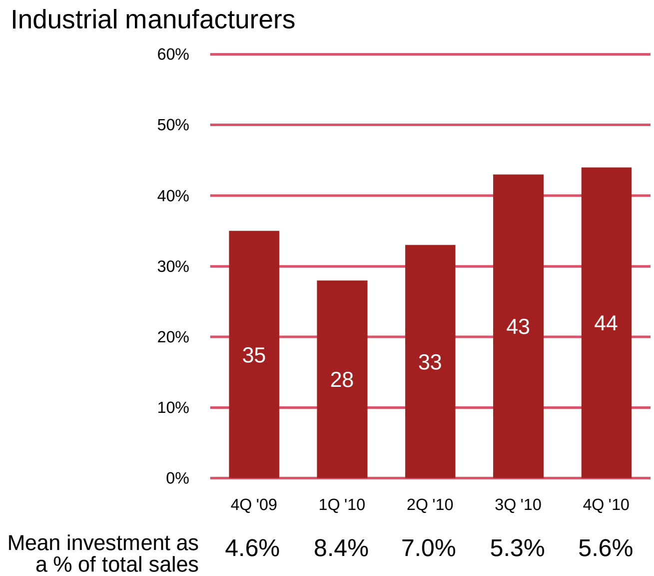
Note: In 4Q 2010 total respondents = 62

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-four percent plan major new investments of capital during the next 12 months, a 1-point increase over the prior quarter. The mean investment as a percentage of total sales was slightly higher, at 5.6 percent.

Chart 4.5 Percent planning major new investments of capital



Note: In 4Q 2010 total respondents = 62

Percent planning to increase operational spending

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

Looking at the next 12 months, 82 percent of respondents plan to increase operational spending, down 3 points from last quarter. Leading increased expenditures were new product or service introductions, research and development, geographic expansion, and business acquisitions. Also on the rise are information technology, facilities expansion, and Internet commerce.

Chart 4.6 Percent planning to increase operational spending

Industrial manufacturers

	4Q '09	1Q '10	2Q '10	3Q '10	4Q '10
Percent planning to increase spending (net)	65%	70%	80%	85%	82%
• New product or service introduction	37%	43%	52%	47%	50%
• Research and development	37%	28%	32%	42%	45%
• Geographic expansion	27%	22%	28%	33%	42%
• Business acquisition	23%	23%	38%	43%	39%
• Information technology	22%	20%	22%	28%	34%
• Facilities expansion	22%	20%	23%	27%	32%
• Marketing & sales promotion	12%	13%	13%	12%	15%
• Internet commerce	3%	5%	7%	3%	11%
• Advertising	8%	12%	5%	7%	5%

Note: In 4Q 2010 total respondents = 62

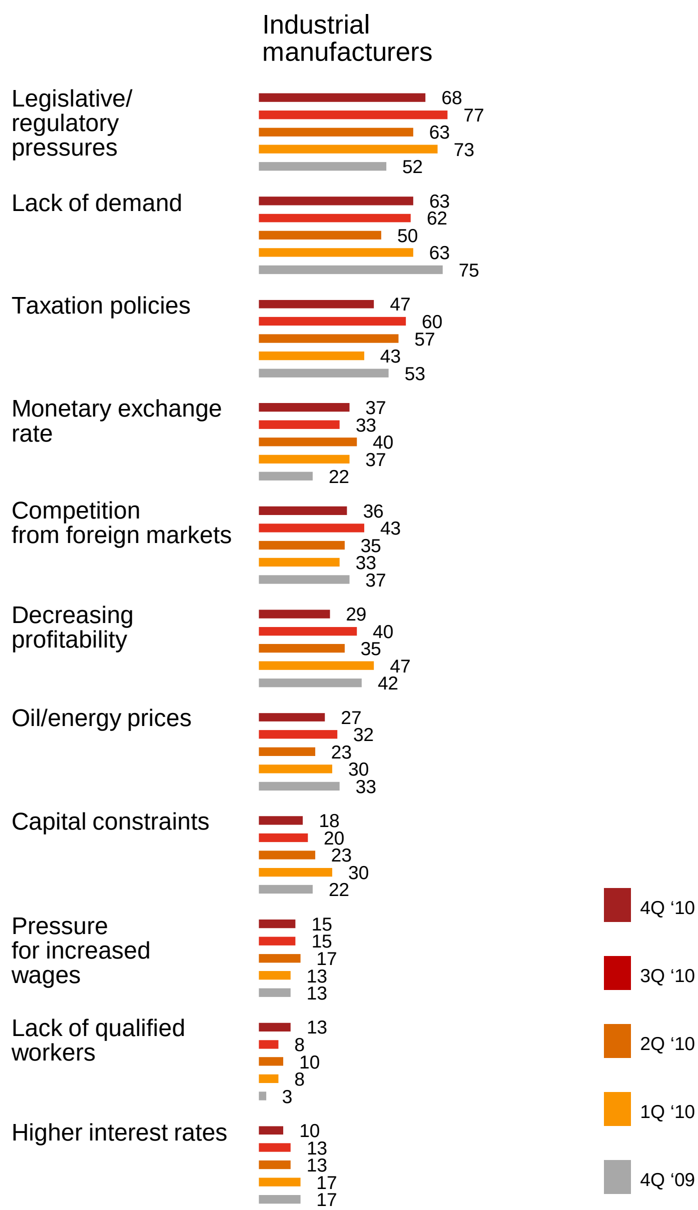
Expected barriers to business growth

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

Legislative/regulatory pressures remained the most likely barrier to growth over the next 12 months, at 68 percent. Lack of demand remained second, at 63 percent. Taxation policies dropped 13 points to 47 percent. Concern about competition from foreign markets also dropped from 43 percent to 36 percent. Concern about monetary exchange rates increased slightly to 37 percent, while the number concerned about decreasing profitability dropped to 29 percent. Oil/energy ranked 5 points lower, at 27 percent. The biggest increase in concern was over lack of qualified workers, which climbed 5 points to 13 percent.

Note: In 4Q 2010 total respondents = 62

Chart 4.7 Expected barriers to business growth



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 1 point to 39 percent. Of that number, most are looking at purchasing another business (36 percent). Plans for expansion to markets abroad rose to 37 percent while plans for new facilities abroad also increased to 27 percent. New strategic alliances remained high, at 34 percent.

Chart 4.8 Plans for M&A and other business initiatives

Industrial manufacturers

	4Q '09	1Q '10	2Q '10	3Q '10	4Q '10
New business initiatives (net)	57%	60%	55%	65%	66%
• M&A activity (net)	28%	37%	33%	38%	39%
- Purchase another business	27%	33%	33%	37%	36%
- Sale part/all own business	7%	8%	7%	8%	10%
- Equity carve-out/spin-off	3%	3%	2%	2%	2%
• Expand to new markets abroad	20%	28%	27%	30%	37%
• New strategic alliance	38%	33%	32%	37%	34%
• New joint venture	25%	27%	30%	33%	29%
• New facilities abroad	12%	15%	20%	18%	27%
• Reduce activity in markets abroad	10%	10%	7%	8%	7%
• Close/reduce facilities abroad	8%	8%	5%	7%	7%

Note: In 4Q 2010 total respondents = 62

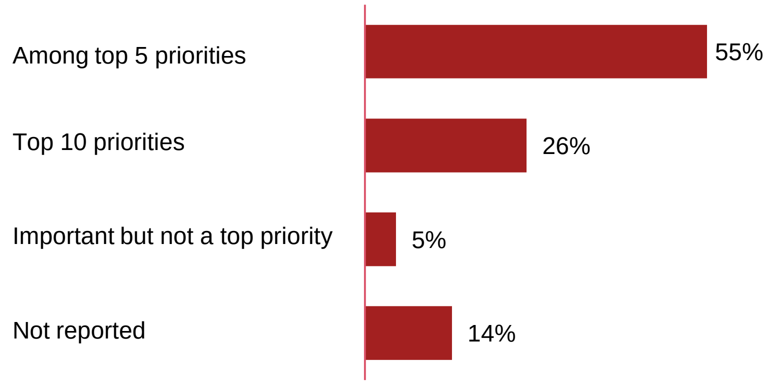
Special topic: Corporate reputation and the impact of issues on business operations

Importance of corporate reputation

Among your organization's priorities over the next 3-5 years, how important is it to more effectively manage your firm's reputation with your key stakeholders? (e.g., governments, customers, shareowners, employees)

Corporate reputation in order to maintain trust with key stakeholders is a top 10 priority for 81 percent of industrial manufacturers who responded to the special topic.

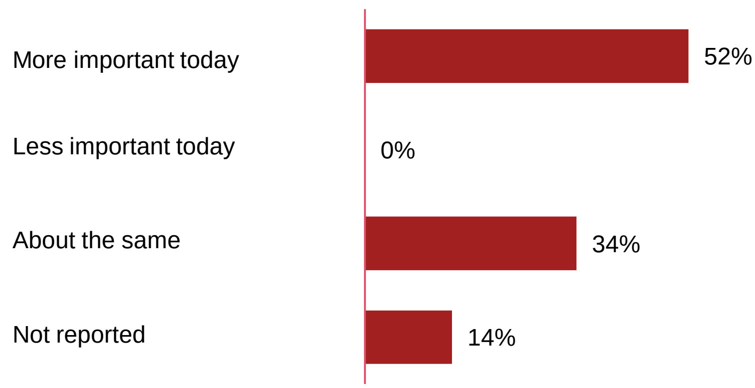
Chart 5.1 Corporate reputation as priority



How important is it now to maintain the trust of key stakeholders than it had been over the past 2-3 years?

Fifty-two percent feel trust of key stakeholders is more important now than it has been within the past two to three years; none thinks it is less important.

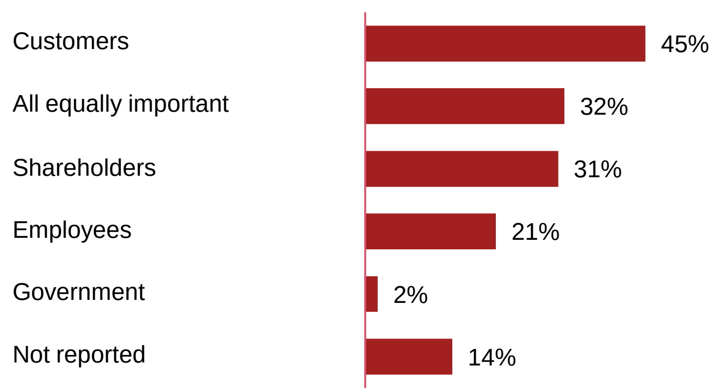
Chart 5.2 Importance of corporate reputation today



Which of your key stakeholder groups will be of increasing importance to your corporation over the next 3-5 years in maintaining its reputation and trust?

Customers are ranked first, followed by shareholders and employees. Nearly a third of respondents felt all of these stakeholder groups are equally important.

Chart 5.3 Increasing importance of key stakeholder groups



Third-party verification and certification

To improve transparency with stakeholders, do you expect to obtain third-party verification or certification for you own company's operations in any of the following areas within the next 1-2 years?

Eighty-one percent of those who responded to the special topic survey questions said that within the next two years, third-party verifications or certifications in one or more areas will be important to improve transparency with stakeholders.

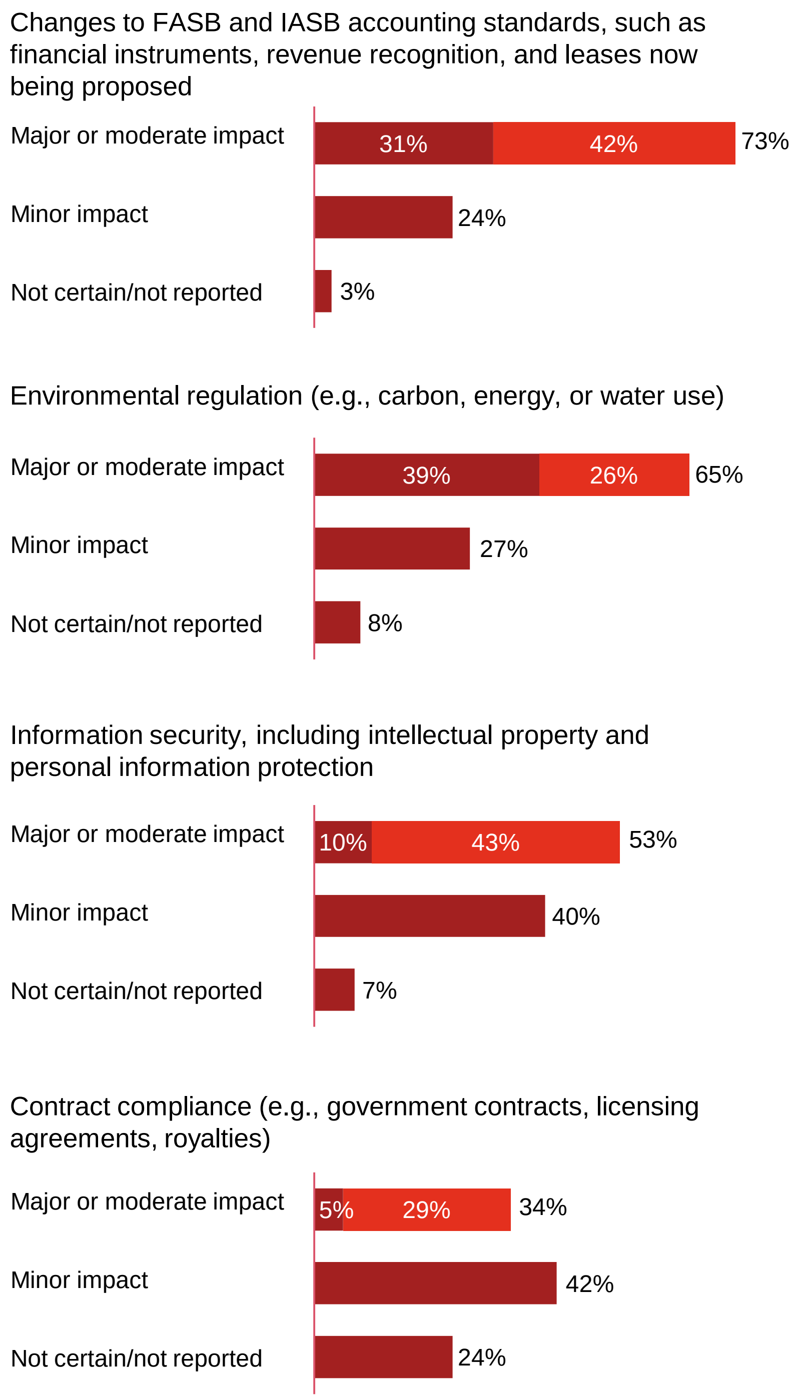
Chart 5.4 Third-party verification and certification

Impact on how business operates within next 3-5 years

To what extent are the following likely to have a major, moderate, or minor impact on how your business operates over the next 3-5 years?

Changes to FASB and IASB accounting standards and environmental regulations are cited as having the greatest potential impact on how businesses will operate over the next three to five years.

Chart 5.5 Impact on how business operates over next 3-5 years



Survey demographics and research methodology

Demographics

Who	Senior executives of US-based, industrial manufacturing organizations
Interview dates	October 29, 2010 to January 5, 2011
	Industrial manufacturers (62)
Average number of employees	7,398
Average business unit revenue	$2.52 billion
Average enterprise revenue	$5.94 billion
Market capitalization	$8.07 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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