

Manufacturing Barometer

**Business outlook report
January 2012**

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Quarterly highlights

Key findings:

In the fourth quarter of 2011, PwC interviewed 60 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, uncertainty prevails and own-company revenue forecasts were lowered a point below calendar year 2011 final forecasts. Yet international sales continue to be strong, and lower levels are expected in chief barriers to growth, including basic demand. And positive spending is on the rise, along with some modest employment gains. Interestingly, gross margins were up in 4Q 2011, with fewer cost increases and more own price increases reported. Only 18 percent expect decreasing profitability in the year ahead.

- **Uncertainty still prevails.** Optimism about the prospects for the US economy over the next 12 months rose in 4Q 2011 from an all-time low of 5 percent to 30 percent, up 25 points quarter-to-quarter among industrial manufacturers. The majority, 57 percent, remain uncertain (down 20 points). But only 13 percent are pessimistic (off 5 points).

Among panelists selling abroad, only 16 percent are optimistic about prospects for the world economy over the next 12 months (up 9 points from last quarter's low). Most, 64 percent, remain uncertain (down 8 points), while pessimism is at 20 percent (off one point).

- **Revenue projections lowered.** The projected average growth rate for own-company revenue over the next 12 months was lowered from 5.0 percent in the prior quarter to 4.4 percent, a correction of half a point. This prospective growth rate is nearly a point below the final 2011 calendar year rate of 5.3 percent. Yet, looking ahead, 83 percent of industrial manufacturing panelists expect positive revenue growth for their own companies in the year ahead— 12 percent forecasting double-digit growth and 71 percent forecasting single-digit growth. Only 7 percent forecast negative growth, and 10 percent now forecast zero growth. On a quarter-to-quarter basis, fewer panelists are forecasting double-digit growth over the next 12 months, 12 percent (off 10 points from 22 percent last quarter).
- **International sales continue.** Industrial manufacturing panelists marketing abroad expect international sales to contribute 38 percent of their total revenue over the next 12 months – that is same as the prior quarter and a year ago (38 percent). In fourth-quarter 2011, 36 percent reported an increase in international sales, 58 percent about the same as the prior quarter, and only 6 percent reported a decrease. Overall, despite uncertainty about world markets in Europe and Asia, own-company international sales forecasts continue to be strong.

- **Barriers to growth lower.** Legislative/regulatory pressures was the leading potential barrier to growth over the next 12 months, cited by 50 percent (off 5 points). Lack of demand and oil/energy prices were next at 47 percent; both were off from the prior quarter. Taxation concerns dropped 7 points to 33 percent. And, importantly, concern about decreasing profitability was off sharply to 18 percent.

- **Spending plans on the rise.** More industrial manufacturing panelists are planning major new investments of capital over the next 12 months, 67 percent (up 12 points). However, their average level of new-investment spending is expected to be lower— 4.2 percent of sales versus 5.9 percent in the prior quarter.

More operational spending is also expected— cited by 90 percent over the next 12 months (up 5 points). Increased spending is cited for new product or service introductions (57 percent), information technology (50 percent), and business acquisitions (40 percent). And geographic expansion remained moderately high at 38 percent. However, research and development was off from last quarter's high of 48 percent to 40 percent. Finally, plans for marketing and sales promotion and advertising remain on the low side.

Plans for M&A activity over the next 12 months rose to 38 percent (up 3 points). Expansion to new markets abroad was at the 40 percent level, as was joint ventures, and new facilities abroad rose to 32 percent (up 4 points).

- **Some employment gains.** Thirty-seven percent of panelists expect positive hiring over the next 12 months (off 1 point). But the net workforce composite projection rose from minus 0.2 percent in the prior quarter to a plus 0.7 percent. This represents some modest gains and a break from a declining pattern.
- **Margins increased.** In 4Q 2011, 38 percent reported higher gross margins, only 15 percent lower, for a net 23 percent higher (up 15 points from the prior quarter). Fewer reported higher costs, net 17 percent (11 points below the prior quarter). And more reported higher prices, net 22 percent (12 points above the prior quarter).

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: Supply chain and global operations

- **Importance of supply chain.** Three quarters (77 percent) of industrial manufacturers surveyed believe it is very or extremely important to the growth of its global business to improve their companies' supply chain over the next 2-3 years. Only 12 percent felt it was only somewhat important or not important, and 11 percent were not reported.
- **Global operations improvements.** It is very/extremely important to improve their companies' globalized product development operations (43 percent), supply base (40 percent), and manufacturing footprint (39 percent). Also some thought it was very/extremely important to address their globalized distribution system (33 percent) and globalized service operations (32 percent).
- **Definite plans to improve global operations.** Over the next 12-18 months, definite plans for major/minor improvement of globalized distribution systems was cited by 75 percent, while supply base improvement was cited by 67 percent, global manufacturing footprint by 67 percent, global product development operations by 60 percent, and global service operations by 60 percent.
- **Scalable to meet global requirements.** Seventy-eight percent of industrial manufacturers surveyed believe their current business is scalable to meet global requirements at target performance levels over the next 2-3 years— 50 percent definitely and 28 percent probably. Only 5 percent thought not, while 5 percent were uncertain and 12 percent not reported.
- **Need to rethink and/or reprioritize manufacturing core competencies.** The majority (52 percent) of panelists envision the need to rethink and/or reprioritize their companies' manufacturing core competences in order to grow and optimize their business over the next 2-3 years. Thirty-nine percent felt no need to do so, while 3 percent were uncertain and 6 percent not reported.
- **Need to partner strategic suppliers.** Overall, 57 percent of panelists envisioned a need to partner in new ways with their strategic suppliers in order to grow and optimize their business over the next 2-3 years. Twenty-seven percent felt no need to partner, while 10 percent were not certain and 6 percent not reported.

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
	4Q '10	1Q '11	2Q '11	3Q '11	4Q '11	3Q – 4Q'11	
Optimistic about US economy	63%	57%	48%	5%	30%	↑	8
Optimistic about world economy	60%	44%	38%	7%	16%	↑	10
Expect positive revenue growth	84%	89%	90%	75%	83%	↑	20
Average growth rate expected	6.6%	7.0%	6.5%	5.0%	4.4%	↓	20
Planning major new investments	44%	49%	52%	55%	67%	↑	24
New investments as a % of sales	5.6%	5.4%	7.0%	5.9%	4.2%	↓	24
Planning to hire	48%	51%	52%	38%	37%	=	22
New workers as a % of workforce (net)	1.2%	1.3%	0.3%	-0.2%	0.7%	↑	22
Expected barriers to growth							
• Legislative/regulatory pressures	68%	54%	60%	55%	50%	↓	26
• Lack of demand	63%	41%	40%	57%	47%	↓	26
• Oil/energy prices	27%	65%	70%	55%	47%	↓	26
• Competition from foreign markets	36%	37%	37%	33%	37%	↑	26
• Monetary exchange rate	37%	29%	38%	33%	37%	↑	26
• Taxation policies	47%	33%	53%	40%	33%	↓	26
• Pressure for increased wages	15%	21%	32%	22%	22%	=	26
• Lack of qualified workers	13%	25%	17%	17%	20%	↑	26
• Decreasing profitability	29%	22%	33%	35%	18%	↓	26
• Higher interest rates	10%	19%	13%	10%	18%	↑	26
• Capital constraints	18%	14%	10%	13%	15%	=	26

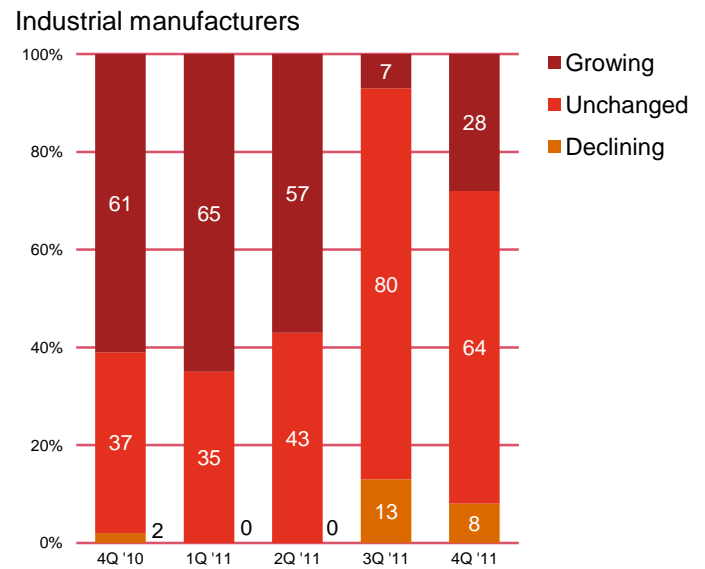
Economic views

View of the US economy, this quarter

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

In fourth-quarter 2011, 28 percent of US industrial manufacturers surveyed believed the US economy was growing, up 21 points from the prior quarter's low. Only 8 percent believed it was declining, and 64 percent saw no change from third-quarter 2011.

Chart 2.1 View of the US economy, this quarter



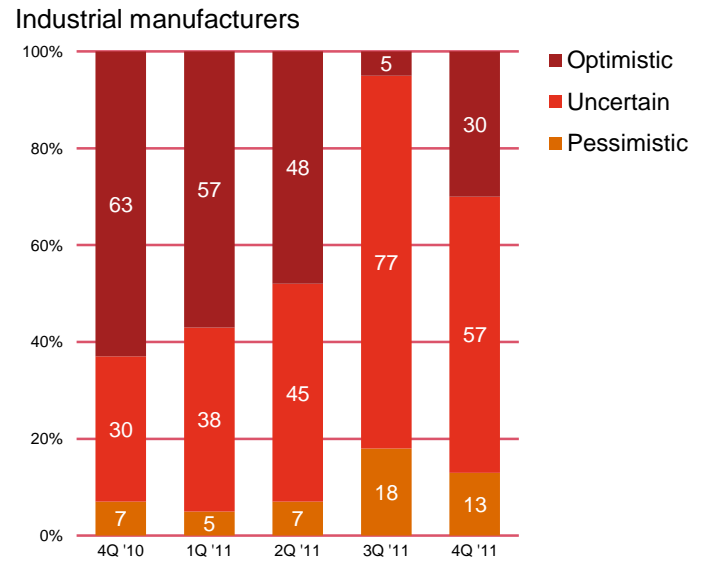
Note: In 4Q 2011 total respondents = 60

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, 30 percent of respondents expressed optimism about the 12-month outlook for the US economy, up 25 points from the prior quarter's low. Thirteen percent were pessimistic (off 5 points), while most, 57 percent, were uncertain.

Chart 2.2 View of the US economy, next 12 months



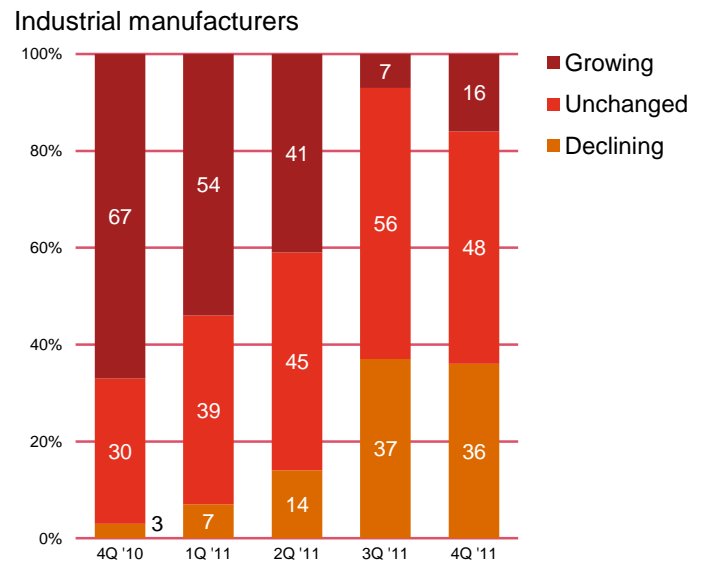
Note: In 4Q 2011 total respondents = 60

View of the world economy, this quarter

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

In fourth-quarter 2011, 16 percent of the panelists marketing abroad viewed the world economy as growing, up 9 points from the prior quarter. Thirty-six percent believed it was declining, off 1 point from the third quarter, and 48 percent said they saw no change.

Chart 2.3 View of the world economy, this quarter



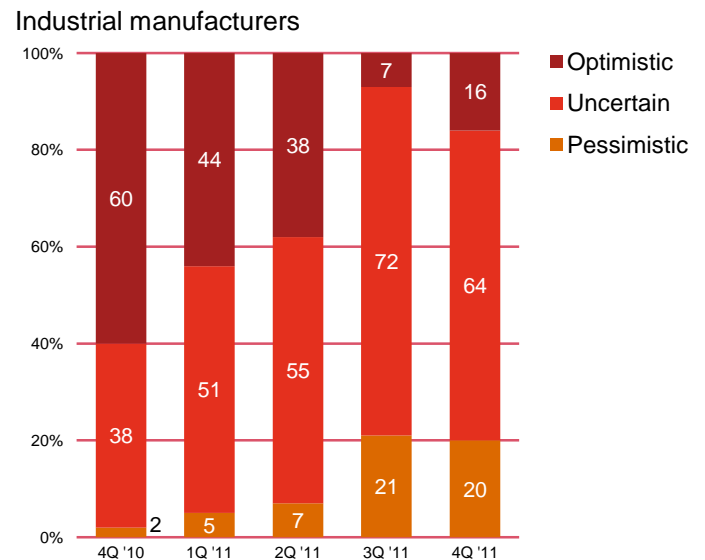
Note: In 4Q 2011 those marketing abroad = 56

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)

Looking ahead, 16 percent of US-based industrial manufacturers who market abroad are optimistic about the prospects for the world economy over the next 12 months, up 9 points from the prior quarter. Twenty percent are pessimistic (off 1 point), while the majority, 64 percent, are uncertain.

Chart 2.4 View of the world economy, next 12 months



Note: In 4Q 2011 those marketing abroad = 56

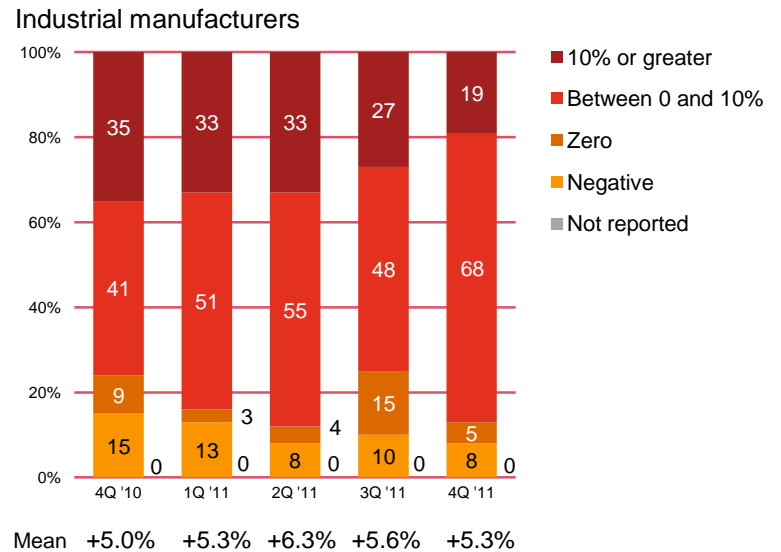
Company performance

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 in the calendar year 2011 declined slightly from 5.6 percent in third-quarter 2011 to 5.3 percent in the fourth quarter. Eighty-seven percent of respondents said they had positive own-company growth, with 19 percent with double digits and 68 percent with single-digit growth. Eight percent were on the negative side, while 5 percent had zero growth.

Chart 3.1 Company revenue growth, calendar year



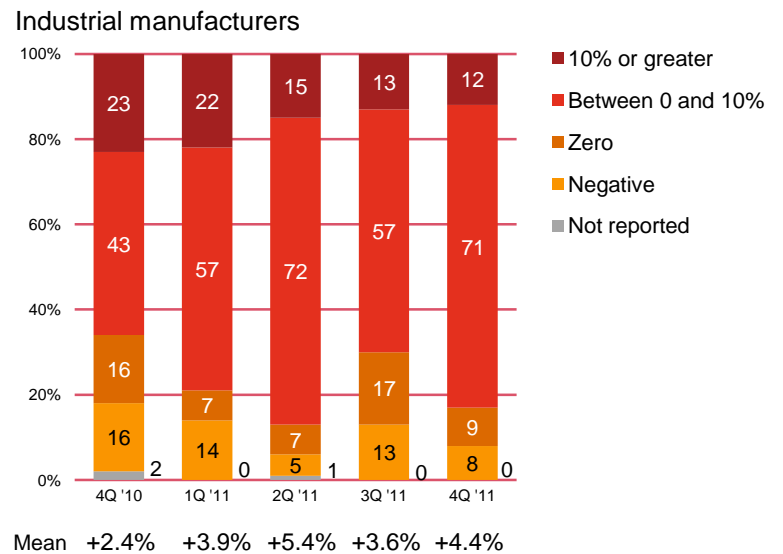
Note: In 4Q 2011 total respondents = 60

Industry growth, calendar year

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

Industry growth estimates for calendar-year 2011 grew from 3.6 percent in the prior quarter to 4.4 percent. Eighty-three percent of panelists reported positive industry growth for 2011, 8 percent are on the negative side, and 9 percent reported zero growth this year.

Chart 3.2 Industry growth, calendar year



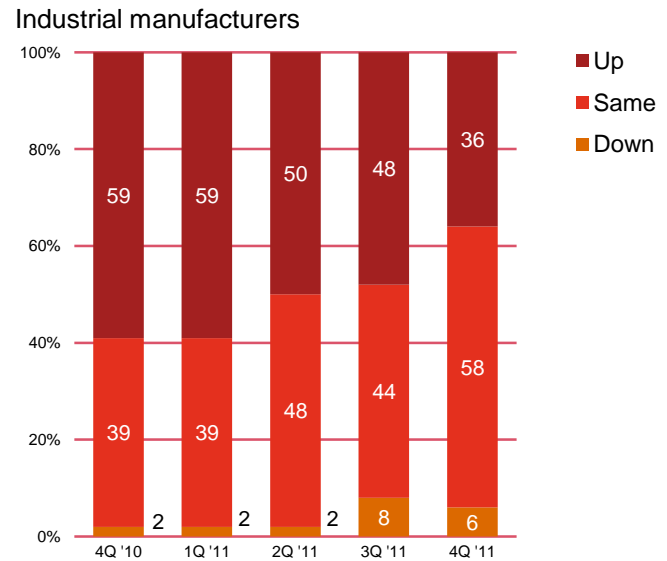
Note: In 4Q 2011 total respondents = 60

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 see moderate upward movement in international revenue in fourth-quarter 2011, with 36 percent reporting an increase in sales (off 12 points), and only 6 percent reporting a decrease. Most, 58 percent, said sales remained about the same.

Chart 3.3 International sales



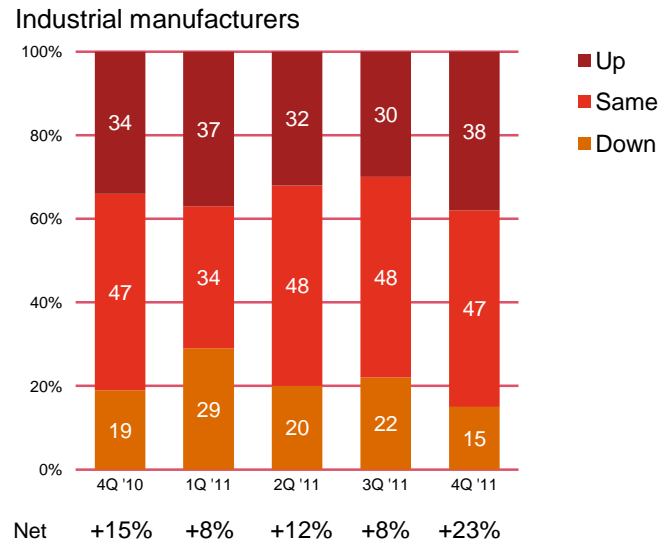
Note: In 4Q 2011 those marketing abroad = 56

Changes in gross margins

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

In fourth-quarter 2011, gross margins increased. They were higher for 38 percent of panelists and lower for 15 percent, for a net plus 23 percent, 15 points higher than the prior quarter's plus 8 percent.

Chart 3.4 Changes in gross margins



Note: In 4Q 2011 total respondents = 60

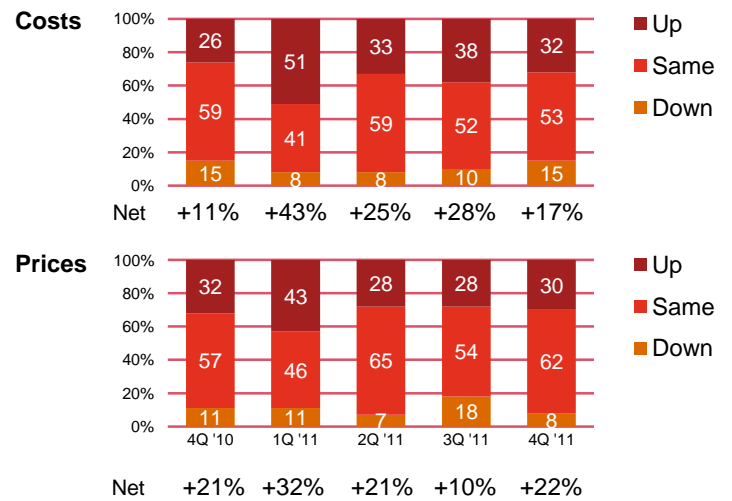
Changes in costs and prices

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

In fourth-quarter 2011, costs and prices remained high: 32 percent of US-based industrial manufacturers reported higher costs, and 15 percent reported lower costs, for a net plus 17 percent, 11 points below the prior quarter. Thirty percent raised prices but 8 percent lowered them, for a net plus 22 percent reporting higher prices (up 12 points).

Chart 3.5 Changes in costs and prices

Industrial manufacturers



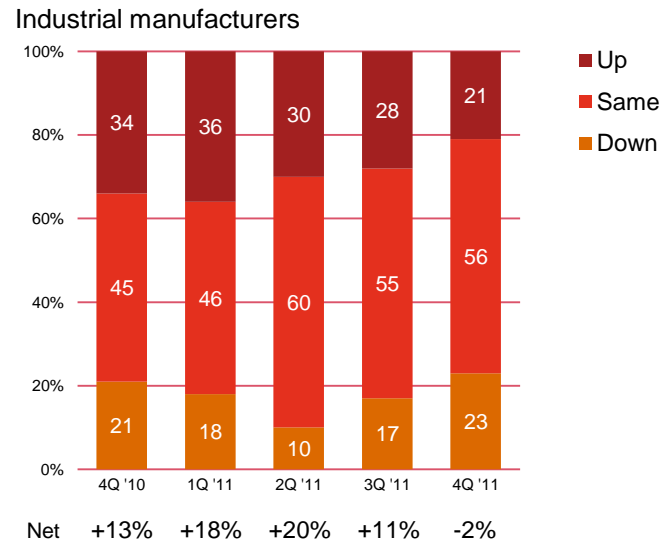
Note: In 4Q 2011 total respondents = 60

Inventory movement

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

Inventories as a percentage of sales grew for 21 percent of US-based industrial manufacturers in the fourth quarter, off 7 points from the prior quarter. Levels were down for 23 percent, for a net minus 2 percent (off 13 points), indicating lower inventories in fourth-quarter 2011.

Chart 3.6 Inventory movement



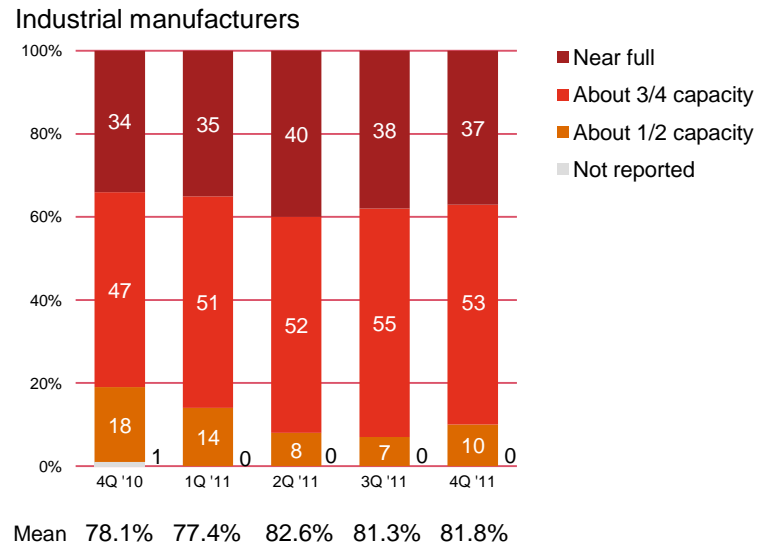
Note: In 4Q 2011 total respondents = 60

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. In the fourth quarter, the mean was 81.8 percent of capacity, up slightly from the previous quarter's 81.3 percent, with 37 percent of industrial manufacturers surveyed claiming to be at or near full capacity (off only 1 point).

Chart 3.7 Level of operating capacity



Note: In 4Q 2011 total respondents = 60

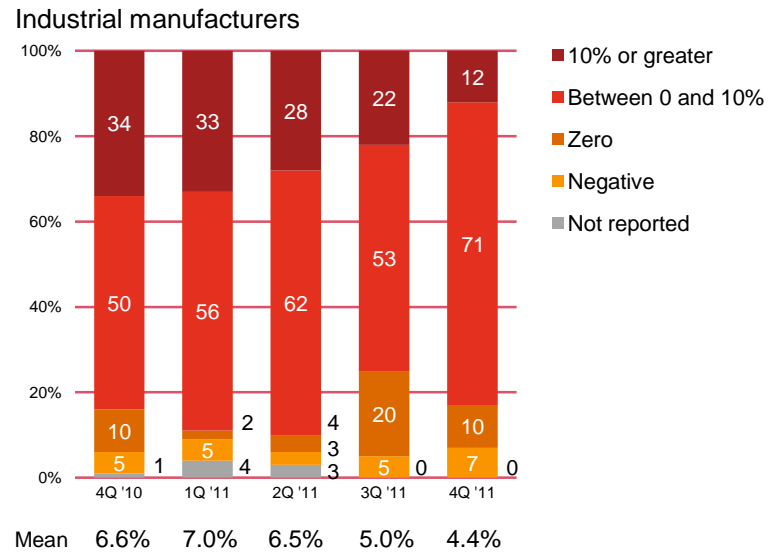
Business outlook, next 12 months

Revenue growth, next 12 months

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

The projected average revenue growth rate over the next 12 months among respondents declined from 5.0 percent in the prior quarter to 4.4 percent, well below last year's 6.6 percent estimate. Eighty-three percent expect positive revenue growth for their own companies, with 12 percent forecasting double-digit growth (down 10 points) and 71 percent forecasting single-digit growth. Only 7 percent forecast negative growth and 10 percent now forecast zero growth.

Chart 4.1 Revenue growth, next 12 months



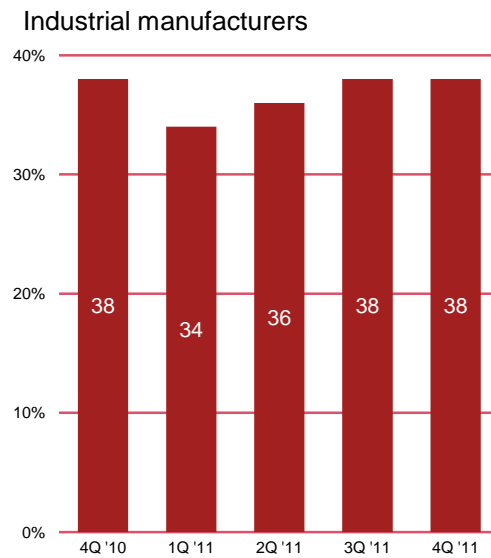
Note: In 4Q 2011 total respondents = 60

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 remained at 38 percent. A year ago, it was at the same 38 percent level.

Chart 4.2 International sales, next 12 months



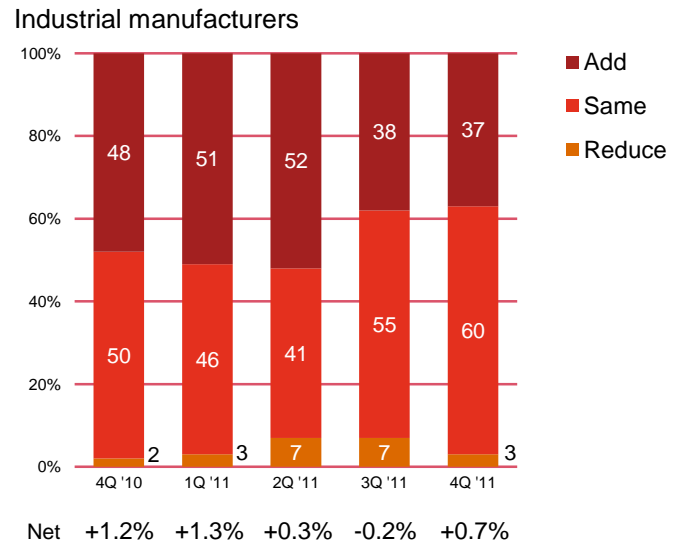
Note: In 4Q 2011 those marketing abroad = 56

Percent planning to hire

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

Thirty-seven percent of industrial manufacturers surveyed plan to add employees to their workforce over the next 12 months, off 1 point from third-quarter 2011 estimates. Only 3 percent plan to reduce the number of full-time equivalent employees, and 60 percent will stay about the same. The net workforce projection is plus 0.7 percent, up from last quarter's minus 0.2 percent, a sign of moderate new hiring in the manufacturing sector.

Chart 4.3 Percent planning to hire



Note: In 4Q 2011 total respondents = 60

Percent planning to hire by type of employee

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

Among the 37 percent of respondents planning to hire within the next 12 months, the most sought-after employees will be professionals/technicians (28 percent), and skilled workers (23 percent). Interest in production workers decreased to 13 percent, off 14 points on a quarter-to-quarter basis.

Chart 4.4 Percent planning to hire by type of employee

Industrial manufacturers					
	4Q '10	1Q '11	2Q '11	3Q '11	4Q '11
Planning to hire (net)	48%	51%	52%	38%	37%
• Professionals/technicians	27%	35%	40%	28%	28%
• Skilled labor	23%	30%	33%	23%	23%
• Production workers	18%	27%	32%	27%	13%
• White collar support	18%	18%	22%	18%	12%
• Sales/marketing	15%	8%	17%	10%	10%

Note: In 4Q 2011 total respondents = 60

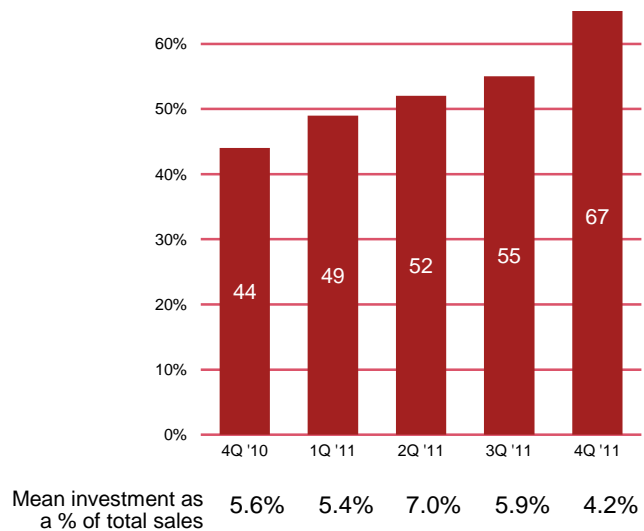
Percent planning major new investments of capital

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?

On the positive side, 67 percent of US industrial products manufacturers surveyed plan major new investments of capital during the next 12 months, a 12-point increase over the prior quarter and 23 points above a year ago. However, the mean investment as a percentage of total sales fell from the prior quarter's 5.9 percent to a lower, 4.2 percent – indicative of moderate spending.

Chart 4.5 Percent planning major new investments of capital

Industrial manufacturers



Note: In 4Q 2011 total respondents = 60

Percent planning to increase operational spending

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

Looking at the next 12 months, 90 percent of respondents plan to increase operational spending, up 5 points from last quarter. Leading increased expenditures were new product or service introductions (57 percent), information technology (50 percent), and business acquisitions (40 percent). R&D was off 8 points to 40 percent. Plans for marketing and sales promotion and advertising declined sharply.

Chart 4.6 Percent planning to increase operational spending

Industrial manufacturers					
	4Q '10	1Q '11	2Q '11	3Q '11	4Q '11
Percent planning to increase spending (net)	82%	86%	88%	85%	90%
• New product or service introduction	50%	49%	60%	43%	57%
• Information technology	34%	41%	48%	42%	50%
• Business acquisition	39%	41%	45%	37%	40%
• Research and development	45%	46%	40%	48%	40%
• Geographic expansion	42%	33%	43%	37%	38%
• Facilities expansion	32%	29%	38%	30%	38%
• Marketing and sales promotion	15%	22%	30%	27%	15%
• Advertising	5%	14%	20%	15%	5%
• Internet commerce	11%	5%	7%	5%	3%

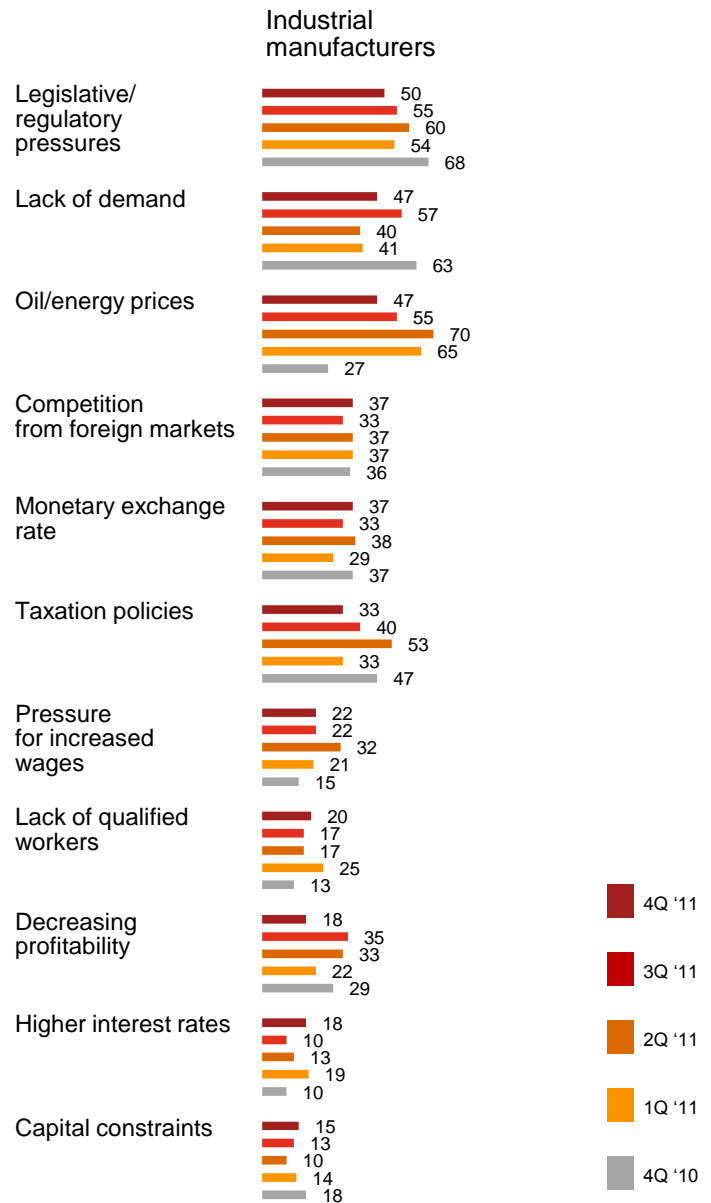
Note: In 4Q 2011 total respondents = 60

Expected barriers to business growth

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

Legislative/regulatory pressures was the leading potential barrier to growth over the next 12 months, cited by 50 percent (off 5 points). Lack of demand and oil/energy prices were next at 47 percent; both were off from the prior quarter. Taxation concerns dropped 7 points to 33 percent. And, importantly, concern about decreasing profitability was off sharply to 18 percent.

Chart 4.7 Expected barriers to business growth



Note: In 4Q 2011 total respondents = 60

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 rose 3 points to 38 percent. Of that number, all are looking at purchasing another business. Plans for expansion to new markets abroad remained a high 40 percent, and new joint ventures rose 10 points to 40 percent. The number planning new strategic alliances rose to 35 percent, and new facilities abroad rose to 32 percent.

Chart 4.8 Plans for M&A and other business initiatives

Industrial manufacturers					
	4Q '10	1Q '11	2Q '11	3Q '11	4Q '11
New business initiatives (net)	66%	64%	73%	62%	70%
• Expand to new markets abroad	37%	33%	45%	40%	40%
• New joint venture	29%	32%	38%	30%	40%
• M&A activity (net)	39%	41%	45%	35%	38%
- Purchase another business	36%	38%	45%	35%	38%
- Sale part/all own business	10%	6%	5%	3%	7%
- Equity carve-out/spin-off	2%	2%	---	2%	3%
• New strategic alliance	34%	41%	37%	32%	35%
• New facilities abroad	27%	22%	35%	28%	32%
• Close/reduce facilities abroad	7%	6%	8%	10%	8%
• Reduce activity in markets abroad	7%	8%	10%	7%	8%

Note: In 4Q 2011 total respondents = 60

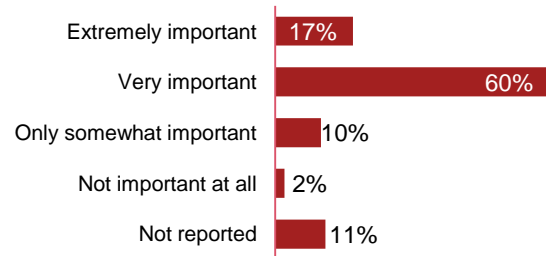
*Special topic:
Global operations
and supply chains*

Supply chain and global operations

How important is improvement of your company's supply chain to the growth of its global business over the next 2-3 years?

Three quarters (77 percent) of industrial manufacturers surveyed believe it is very or extremely important to the growth of its global business to improve their companies' supply chain over the next 2-3 years. Only 12 percent felt it was only somewhat important or not important, and 11 percent were not reported.

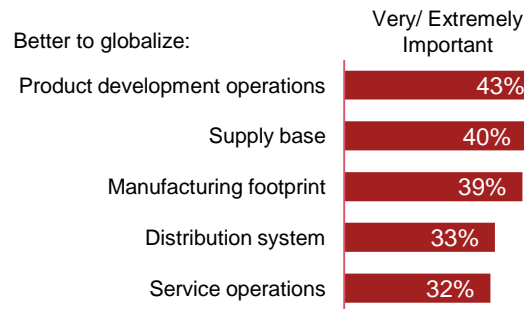
Chart 5.1 Importance of supply chain



In which of the following ways might your company's global operations be improved?

It is very/extremely important to improve their companies' globalized product development operations (43 percent), supply base (40 percent), and manufacturing footprint (39 percent). Also some thought it was very/extremely important to address their globalized distribution system (33 percent) and globalized service operations (32 percent).

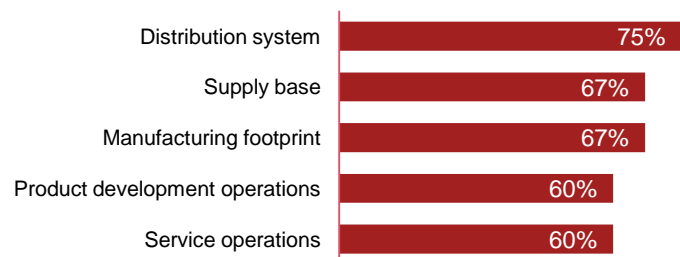
Chart 5.2 Global operations improvements



Does your company have definite plans for major or minor improvements of the following global operations over the next 12-18 months?

Over the next 12-18 months, definite plans for major/minor improvement of globalized distribution systems was cited by 75 percent, while supply base improvement was cited by 67 percent, global manufacturing footprint by 67 percent, global product development operations by 60 percent, and global service operations by 60 percent.

Chart 5.3 Definite improvement plans (major/minor)



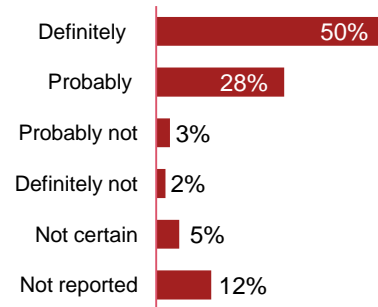
Note: In 3Q 2011 total respondents = 60

Supply chain and global operations

In your opinion, is your current business scalable to meet global requirements at target performance levels over the next 2-3 years?

Seventy-eight percent of industrial manufacturers surveyed believe their current business is scalable to meet global requirements at target performance levels over the next 2-3 years— 50 percent definitely and 28 percent probably. Only 5 percent thought not, while 5 percent were uncertain and 12 percent not reported.

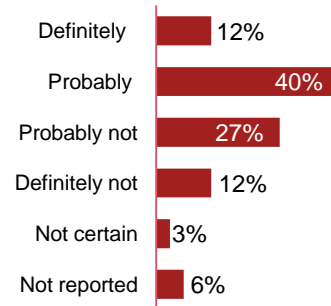
Chart 5.4 Scalable to meet global requirements



Do you envision the need to rethink and/or reprioritize your company's manufacturing core competences in order to grow and optimize your business over the next 2-3 years?

The majority (52 percent) of panelists envision the need to rethink and/or reprioritize their companies' manufacturing core competences in order to grow and optimize their business over the next 2-3 years. Thirty-nine percent felt no need to do so, while 3 percent were uncertain and 6 percent not reported.

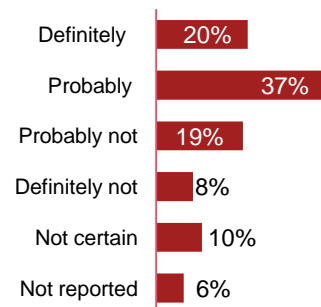
Chart 5.5 Need to rethink/reprioritize manufacturing core competences



Do you envision a need to partner in new ways with your strategic suppliers in order to grow and optimize your business over the next 2-3 years?

Overall, 57 percent of panelists envisioned a need to partner in new ways with their strategic suppliers in order to grow and optimize their business over the next 2-3 years. Twenty-seven percent felt no need to partner, while 10 percent were not certain and 6 percent not reported.

Chart 5.6 Need to partner with strategic suppliers



Note: In 4Q 2011 total respondents = 60

Survey demographics and research methodology

Demographics

Who	Senior executives of US-based, industrial manufacturing organizations
Interview dates	October 26, 2011 to January 11, 2012
	Industrial manufacturers (60)
Average number of employees	8,224
Average business unit revenue	\$3.10 billion
Average enterprise revenue	\$8.80 billion
Market capitalization	\$8.00 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.

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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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