STATE OF MANUFACTURING IN WASHINGTON

2011 REPORT

impact washington

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Manufacturing is playing a vital role in the recovery of the U.S. economy, which is why we once again commissioned the State of Manufacturing in Washington survey. We wanted to capture the mood of this industry, which employs nearly 9 percent of Washington's workforce in family-wage manufacturing jobs. And we wanted to highlight those issues that still hold manufacturing back – taxes, regulations, health care – to provide Washington business, community and government leaders the data so they can work to minimize and eliminate the barriers to growth for manufacturing.

This year's survey looked at the mood of manufacturers in the state, asking CEOs about the climate for business here in Washington and about the future of their own companies. Once again, we found that while manufacturers think the state's business environment is on the wrong track, they are optimistic about their own prospects for the future.

To undertake a comprehensive study such as this, we once again partnered with Rob Autry from Public Opinion Strategies, a national public affairs research firm founded in 1991, to conduct a representative poll of Washington State's manufacturers. The survey was completed in August and September of 2011 among 400 manufacturing executives distributed representatively across geography, industry and company size. This year, we expanded our questions around health care and looked at the differences in attitude between companies that produce finished goods vs. those that are part of a supply chain.

We hope continuing this study will be a significant step in aligning the state, legislature and business community behind the success of manufacturing statewide.

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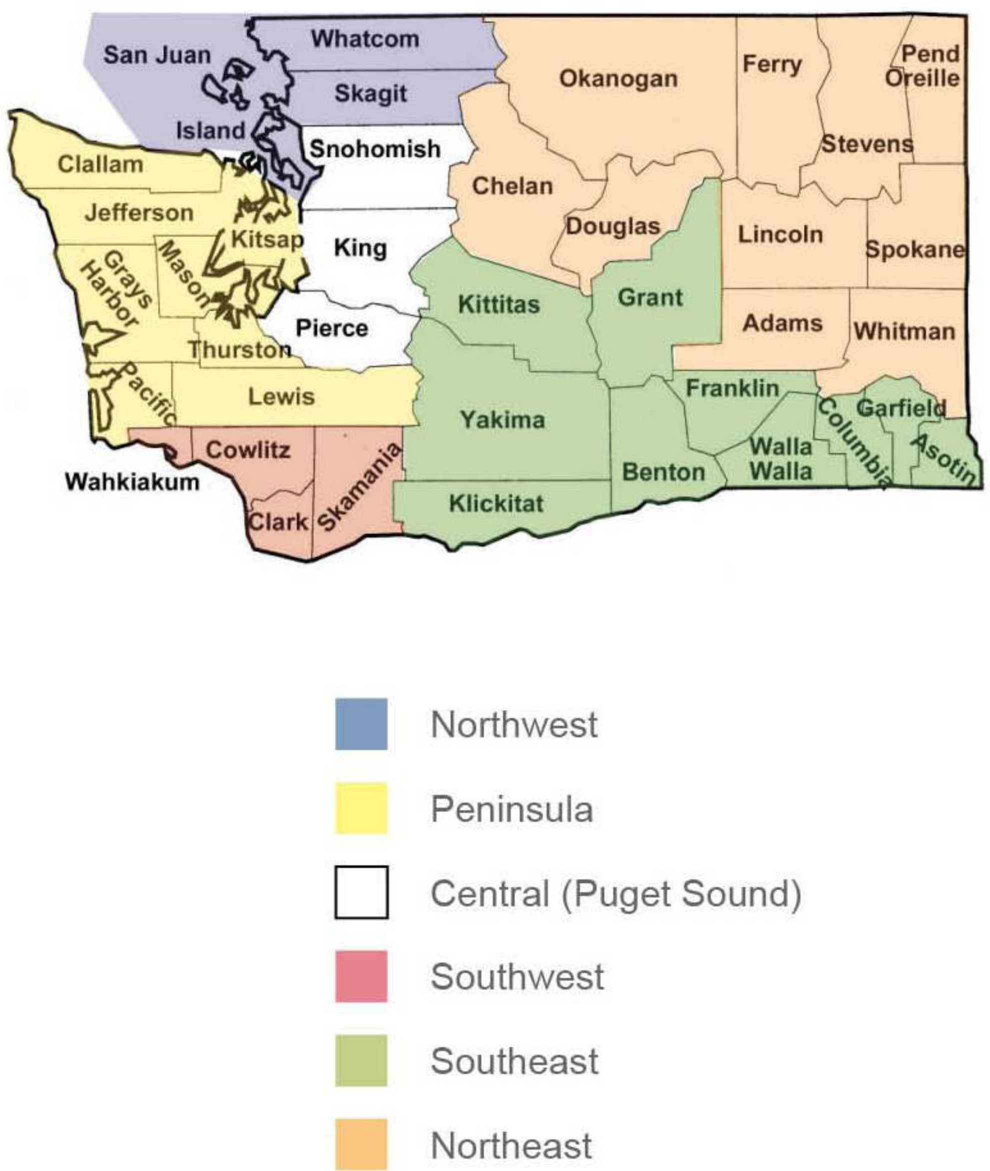
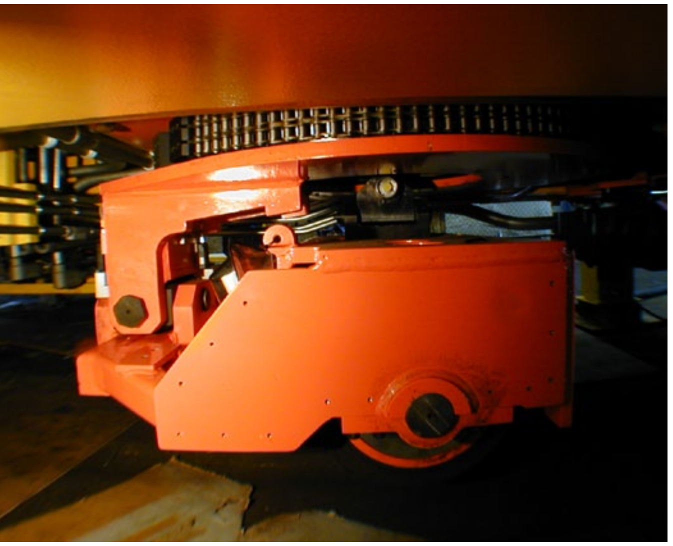
REGIONS FOR POLL

We kept the state divided into six regions for the purpose of the poll – Northwest, Peninsula, Central (Puget Sound), Southwest, Southeast and Northeast. The percentage of companies surveyed in each region corresponds to the percentage of manufacturers in each region.



THE STATE OF MANUFACTURING

The bottom line for Washington Manufacturers is that the business environment is still headed in the wrong direction, but there is optimism for their own companies. This is the same thing we found in last year's survey, and while it's a bit contradictory on the surface, the reason for this could be as simple as an answer we got in one of our 2010 focus groups. According to a manufacturing CEO in Spokane, "I have confidence over what I can control. I can't control what the state or feds do with regard to taxes and regulations, but I can control how I run my own business, and I'm confident in my ability to do that successfully." Whatever the reasons for this disparity, we found the same thing in the 2011 survey.



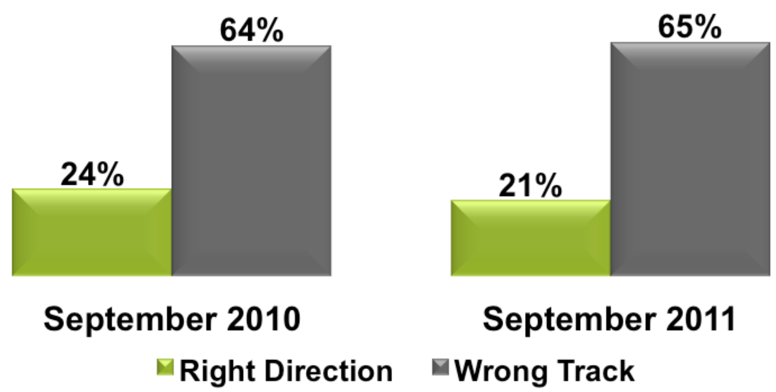
RIGHT TRACK/WRONG TRACK

Two thirds of manufacturing executives in Washington continue to think the state's business environment is headed down the wrong track. Only 21 percent believed the state was on the right track, down from 24 percent in 2010. And 65% felt the state was on the wrong track, up a percentage point from 2010.

For those that believe that things are getting better (or at least aren't getting worse), the biggest reason was that they were seeing things pick up, including hiring. 33 percent of those surveyed said that their belief that things are on the right track are due to business picking up or remaining steady. According to one respondent, "We're in better shape than the rest of the country. The combination of businesses we have in the region makes us more resilient."

For the majority that believes the state is on the wrong track, the main reasons are high taxes and over-regulation. Nearly 50 percent of respondents blame the bad business environment on taxes, regulation and Washington not being business-friendly.

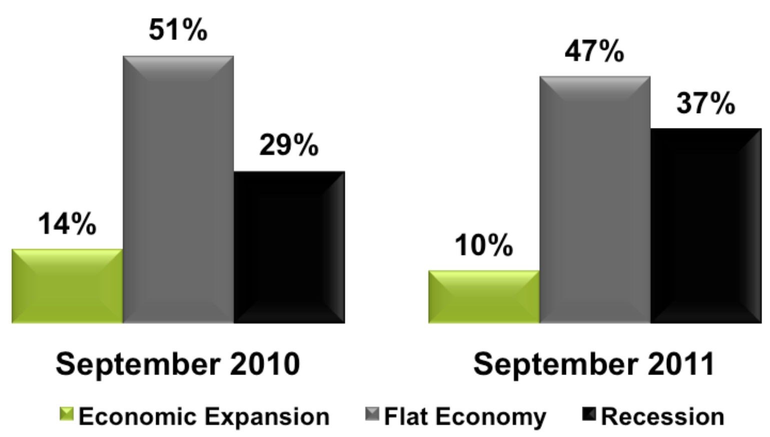
Business Environment in Washington State



"The state government agencies are making it hard for small businesses to operate because of additional regulations, fees and penalties."

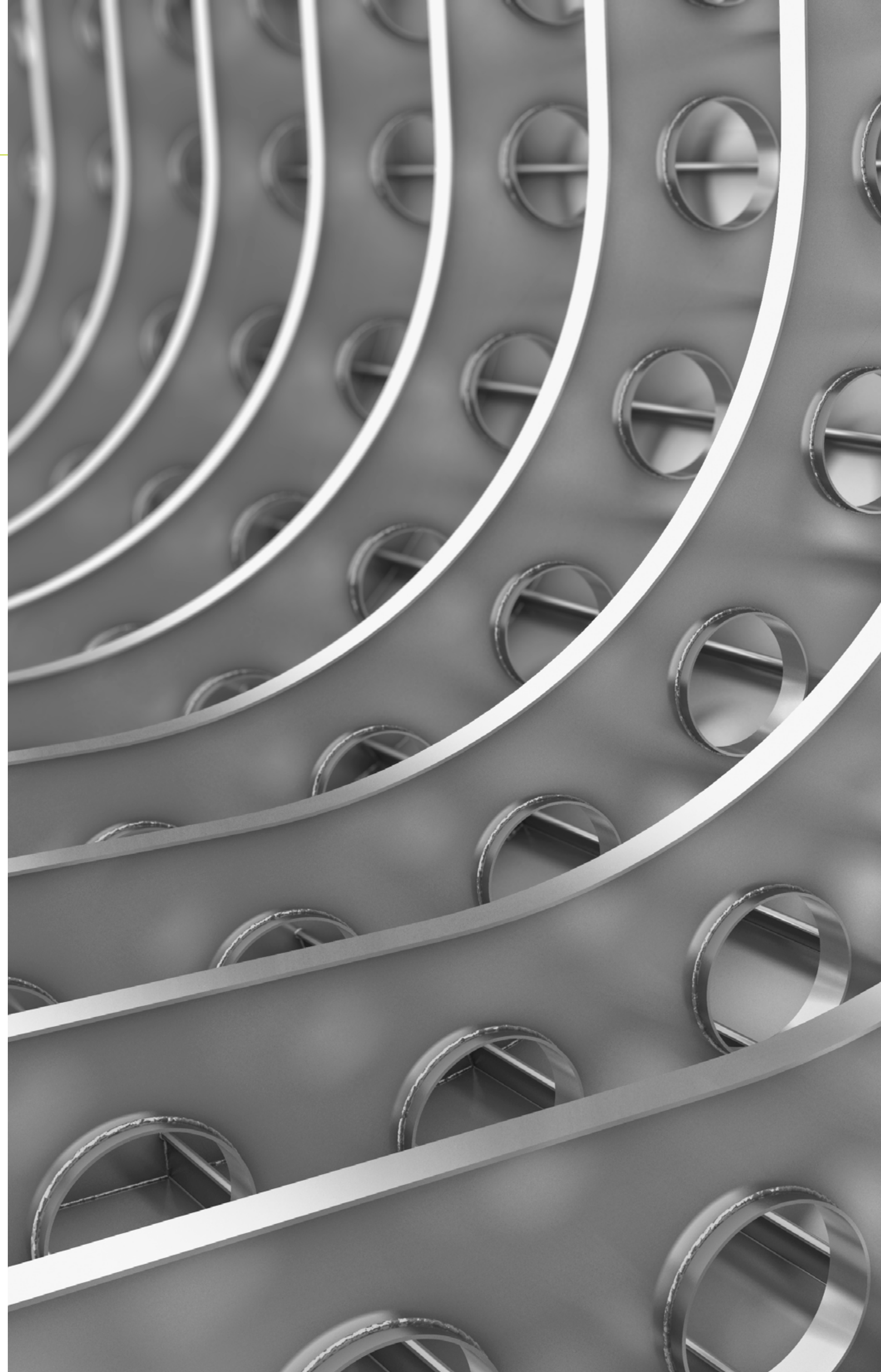
ECONOMIC OUTLOOK

This year, we asked manufacturers about the national economy and we found that pessimism is up in 2011.



However, they are more confident in their own firms, particularly those that are bigger and younger.

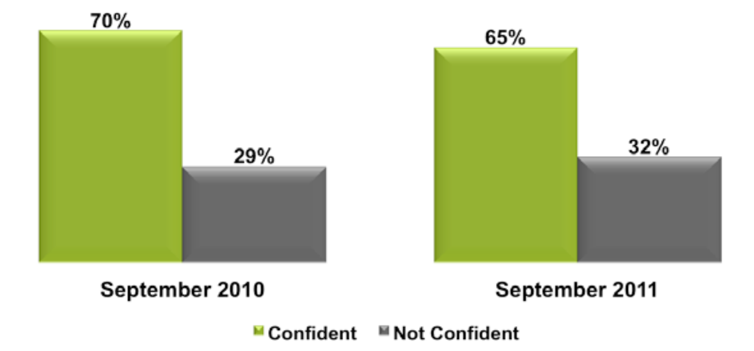
	Expansion nationally	Expansion within personal business
Under $1 million revenue	9%	18%
$1 million - $5 million revenue	5%	23%
Over $5 million revenue	17%	45%
1-10 Years in operation	11%	49%
11-15 Years in operation	10%	17%
Over 15 Years in operation	10%	22%



PROJECTIONS

While a majority (65 percent) are confident about the future of their own firms, that confidence has gone down some since 2010. It seems from the results that the slight drop in confidence is attributable mainly to firms that produce finished goods.

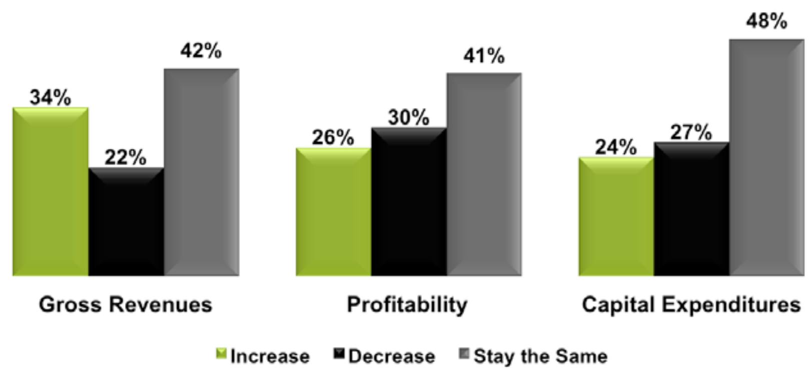
Confidence in Future of Firm (overall)

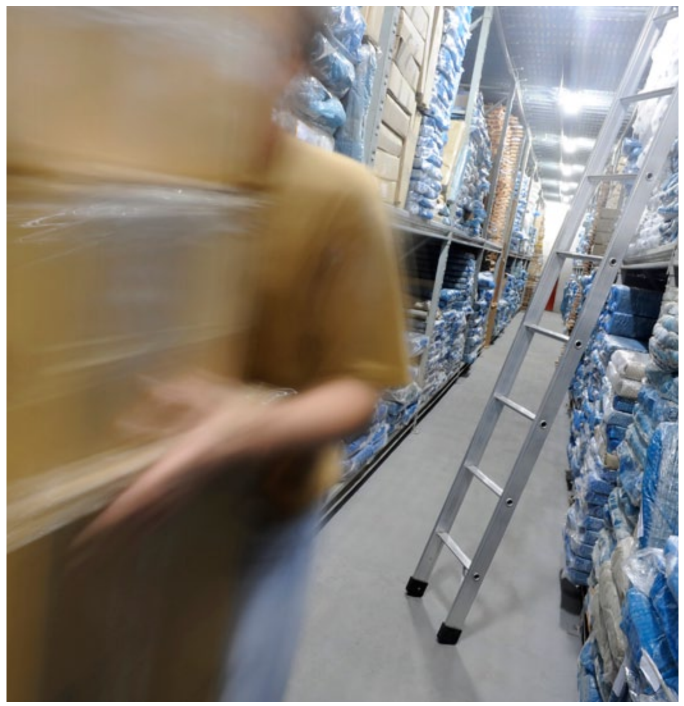


Confidence in Future of Firm (by product type)

PROJECTIONS

Despite the confidence shown by Washington's manufacturers, nearly a quarter of them expect gross revenues to decline, almost a third of them expect their profits to go down, and 27 percent expect to decrease capital expenditures.





PROJECTIONS

However, in comparison to 2010, the projections for increases in all three categories have gone up. In 2010, only 27 percent of respondents expected gross revenues to increase compared to 34 percent in 2011. Only 25 percent expected profitability to increase, remaining about the same in 2011.

Interestingly, the younger and smaller firms are looking for increases in gross revenue, a significant change from 2010. In last year's surveys, it was the smaller firms that projected the highest decreases in revenue.

Forecast Comparison: Gross Revenues
By Revenue Size, Years in Operation, and Product Type

	% Increase in 2010	% Increase in 2011
Under $1 million revenue	17%	30%
$1 million - $5 million revenue	35%	37%
Over $5 mill revenue	48%	48%
1-10 Years in operation	30%	63%
11-15 Years in operation	20%	23%
Over 15 Years in operation	28%	32%
Finished Good	24%	28%
Component	31%	44%

CAPITAL EXPENDITURES

In the biggest change in 2011's future projections, 24 percent of companies expect to increase capital expenditures , up from only 14 percent in 2010. This is an indication that more manufacturers are willing to invest in the future of their businesses, a good sign for continued growth in the future.

The biggest increase in this response came from smaller companies, those with less than $1 million in revenue. In 2010, these firms were the most pessimistic about their prospects for growth, with only 8 percent expecting to increase their capital expenditures. This year, that figure has nearly tripled, with 23% of small manufacturers anticipating an increase in this area.

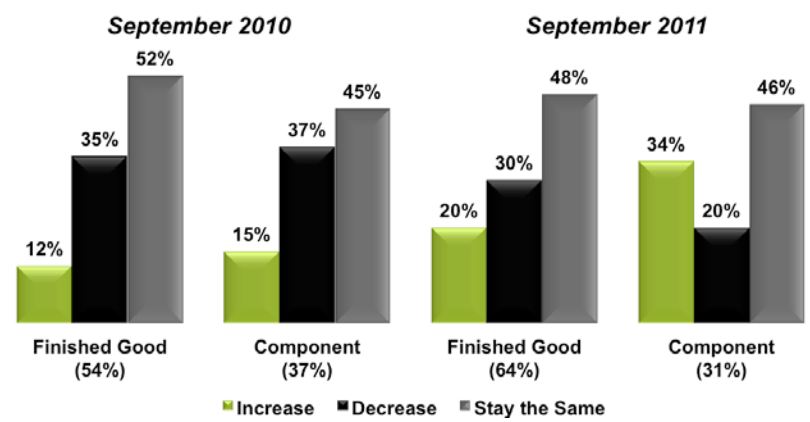
Forecast Comparison: Capital Expenditures By Revenue Size

	% Increase in 2010	% Increase in 2011
Under $1 million revenue	8%	23%
$1 million - $5 million revenue	19%	21%
Over $5 million revenue	27%	37%

CAPITAL EXPENDITURES

When the responses are broken down by component manufacturers versus finished goods producers, those companies that manufacture components are much more likely to invest in capital expenditures, 34 percent to 20 percent. This is double the number of component manufacturers that expected an increase in 2010. This could signify a growth trend among larger OEMs nationwide as well as the health of the aerospace industry locally.

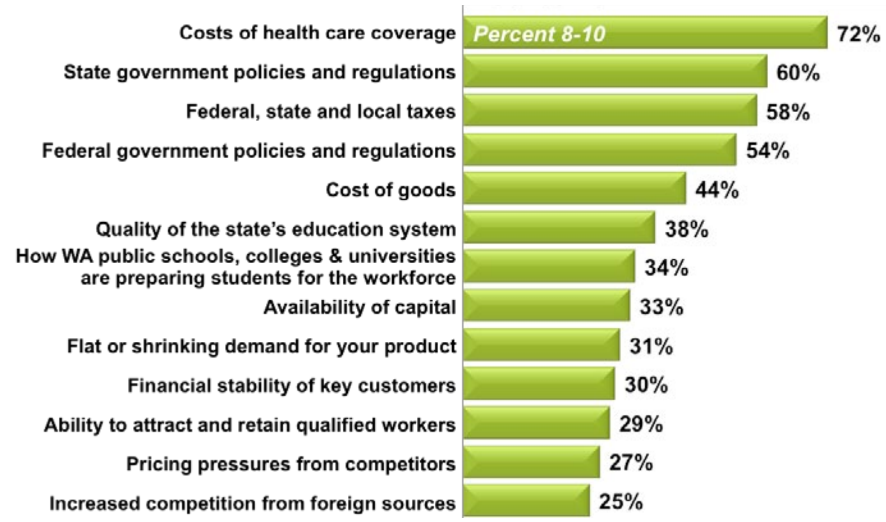
Capital Expenditures Trend By Product Type



POTENTIAL CONCERNS

As we did in 2010, we asked respondents to rate a series of potential concerns for businesses in Washington that could affect their success. They were asked to rate each concern on a scale of 1 to 10, where 1 means you are NOT AT ALL CONCERNED and 10 means you are VERY CONCERNED. We ranked those that were rated from 8 to 10 – a serious concern – by the most respondents.

Similar to last year, the top three were: cost of health care, regulations and taxes. Interestingly, though, state regulations were rated as a higher concern this year, number two on the list, and ahead of federal regulations, which were ranked second in 2010.



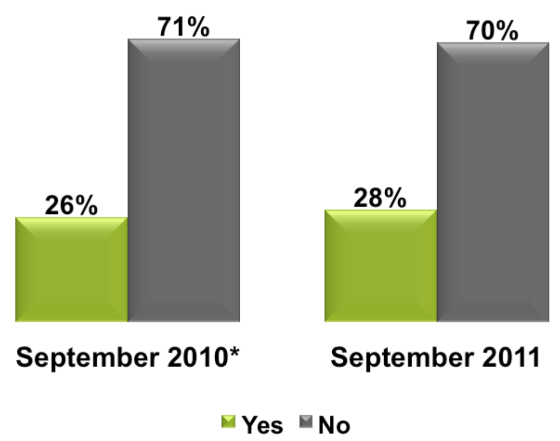
Once again, increased competition from foreign sources ended up at the bottom of the list as did pricing pressures from competitors, which decreased to 27 percent from 33 percent in 2010.

This year, firms are a little more worried about the cost of goods and a little less worried about the financial situation of their customers. Cost of goods went up 8 percent (from 35 percent to 44 percent), and the financial stability of customers decreased by 12 percent (from 42 percent to 30 percent).

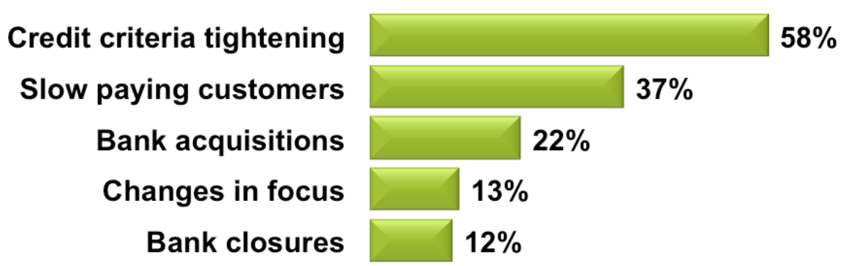
THE CREDIT SQUEEZE

Availability of capital is still a serious issue in 2011. There still seems to be a tightening of credit; banks are still not lending. According to this year's survey, lack of capital availability still only affects about one-third of executives, but it hasn't diminished in importance.

"Over the past year or so, has your firm experienced problems with access to capital?"



The major culprit is the constraint of credit, with nearly 6 in 10 saying that credit criteria tightening is the biggest barrier for them to accessing capital.

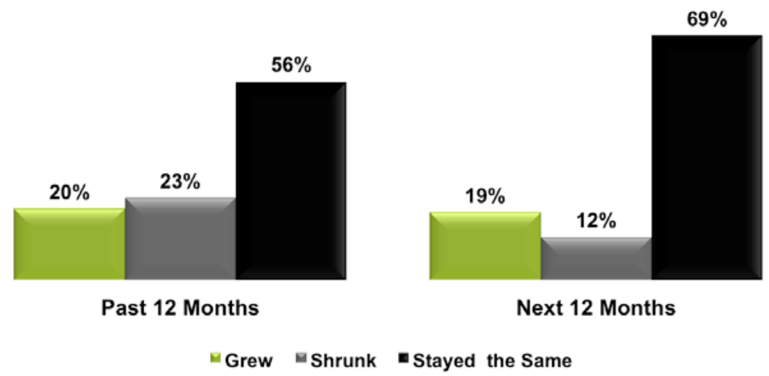


THE CREDIT SQUEEZE

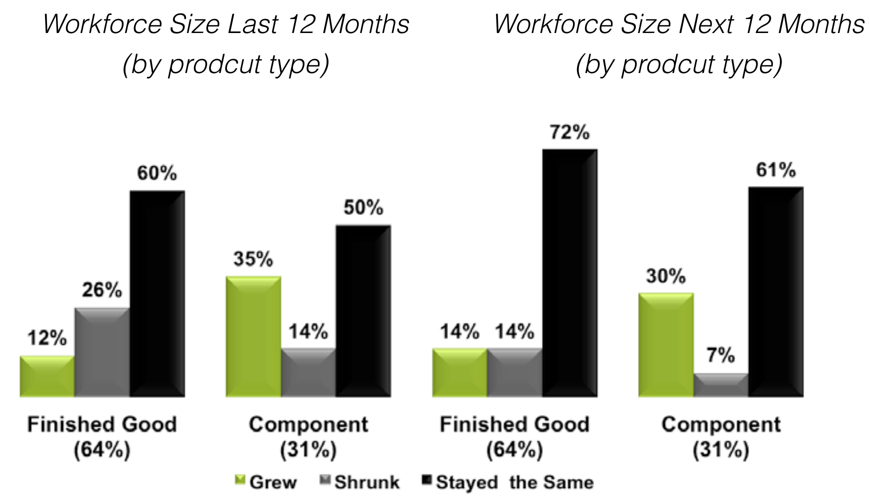
For those firms that are impacted by this – and 87 percent of respondents say it's had an impact on their business – half said the impact is significant.

	2010	2011
A significant impact	39%	50%
A modest impact	35%	37%
Only a minor impact	18%	12%
No impact at all	8%	2%

In 2011, we once again asked manufacturing executives a series of questions on workforce issues, and in this area this year, it seems as if the outlook is somewhat brighter than in 2010. While many of them don't anticipate significant growth in their workforces, half as many expect contraction of their workforces. Only 12 percent of respondents expect their workforce to shrink as opposed to 23 percent in 2010.



The same trend holds when you look at companies by product type. While they don't really anticipate growth, they forecast less contraction, with only 7 percent of component manufacturers anticipating a shrinkage of their workforce.



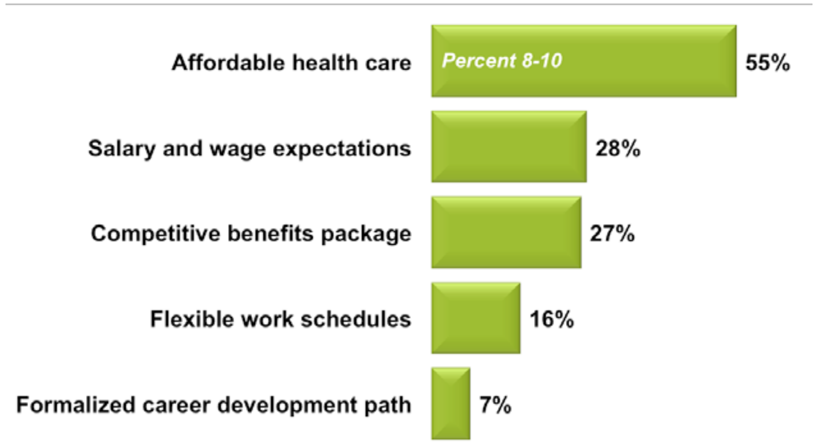
Younger and larger firms are actually pretty confident about increasing the size of their workforce next year. 40 percent of those companies in business for 1 to 10 years are expecting to grow their workforce and nearly 40 percent of firms with revenues over $5 million.

WORKFORCE ISSUES

In 2011, we introduced a new set of questions around attracting and retaining employees. We asked respondents to rate a series of potential ways to attract and retain employees. They were asked to rate each concern on a scale of 1 to 10, where 1 means you are NOT AT ALL IMPORTANT and 10 means the factor is VERY IMPORTANT. We ranked those that were rated from 8 to 10 by the most respondents.

The most significant finding is that providing health care coverage in some form or fashion is seen as a means of attracting and retaining employees, even above wages by almost a 2 to 1 margin.

Attraction and Retention Factors

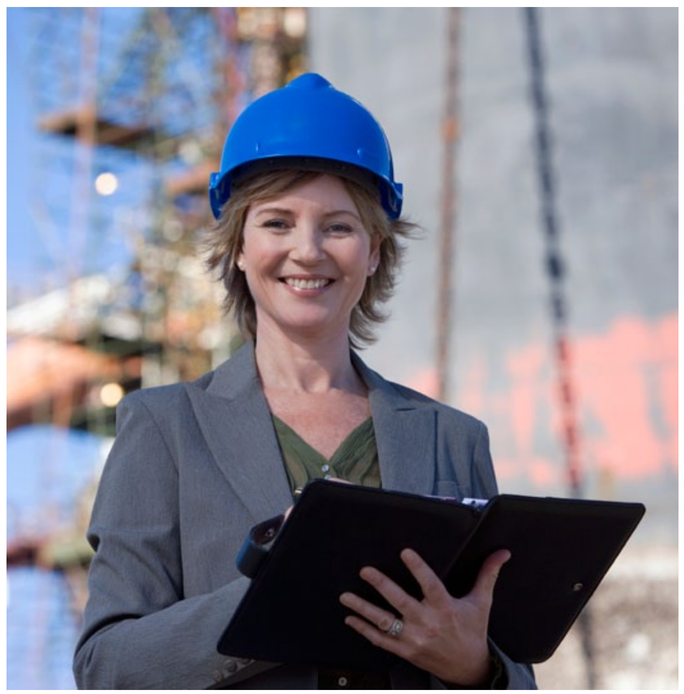


WORKFORCE ISSUES

This factor cut across all demographics. It was listed as the most important factor for firms of all ages, sizes and industries.

Attraction and Retention Factors (By %8-10)
By Revenue Size, Number of Employees, and Years in Operation

	Health care	Wages	Benefits	Schedule	Development
Under $1 million revenue	51%	25%	24%	21%	7%
$1 million - $5 million revenue	62%	42%	35%	11%	4%
Over $5 million revenue	57%	17%	25%	7%	7%
Under 10	50%	24%	23%	20%	7%
More than 11	63%	35%	36%	10%	6%
1-10 Years in operation	51%	27%	22%	19%	19%
11-15 Years in operation	49%	19%	22%	9%	0%
Over 15 Years in operation	57%	30%	29%	17%	6%



HEALTH CARE CONCERNS

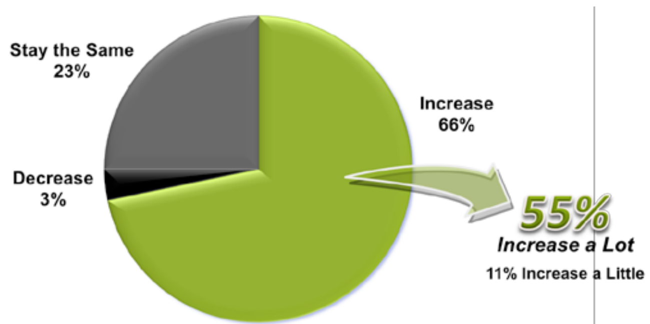
This year, we included a series of questions on health care. Given that it was listed as the top factor in attracting and retaining employees, and because it was also listed at the top of potential threats for companies for two years running, we attempted to dive a little deeper into the subject to learn more about the significant impact health care has on the success of manufacturing in Washington.

What we found is that even though health care was listed as the top factor in attracting and retaining employees, over a third of firms surveyed do not offer any form of health care plan to employees.

	2011
PPO, or Preferred Provider Organization	40%
HMO, or Health Maintenance Organization	14%
HDHP with HSA, or a High-Deductible Health Plan with Health Savings Account	7%
POS, or Point of Service	3%
Indemnity Plan	3%
Do not offer health care plans	36%

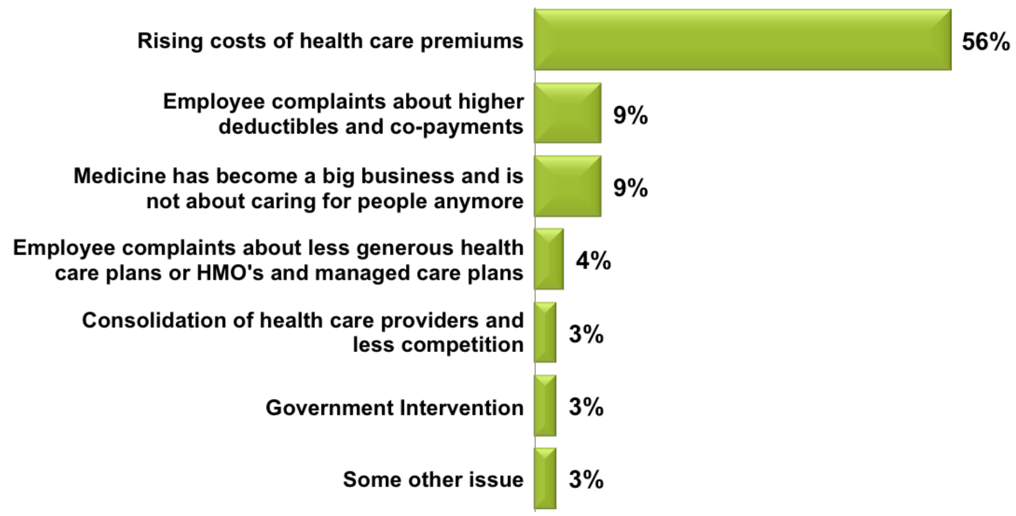
Today, only 58% of firms offer a health care plan to their employees

For most firms, health care costs comprise 20 percent or less of compensation costs. Most of these companies foresee big increases to their (already high) health care costs, with 66 percent anticipating increased costs. The consensus is that the federal health care reform legislation passed in 2010 will increase costs or keep them the same, with only 3 percent of respondents anticipating that their health care costs will decrease due to the new federal health care legislation.

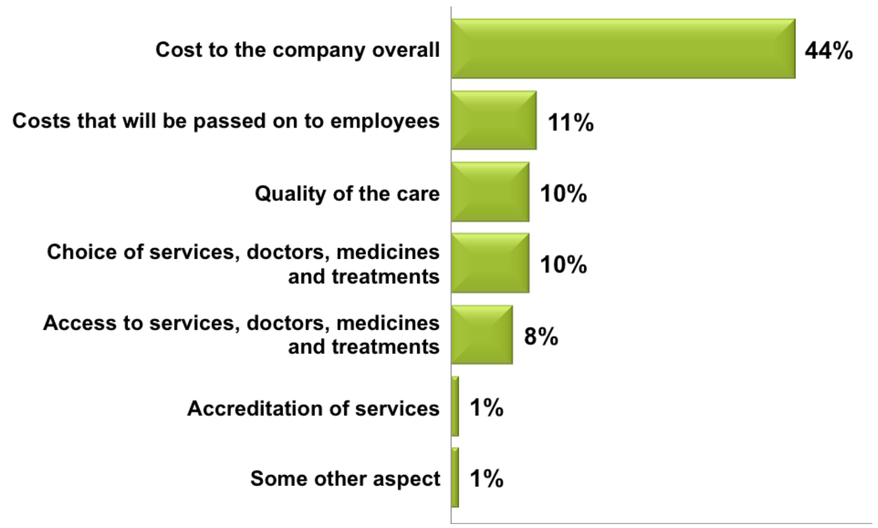


HEALTH CARE CONCERNS

Rising costs are seen as the number one problem with health care, and it's not even close.



Thus, when choosing a health care plan, cost to the company overall is the main determinant, with quality of care, access and choice lagging far behind.



INTERNATIONAL FOOTPRINT

95% of the world's consumers live outside the United States. China's emerging middle class is larger than the entire U.S. population. It is primarily for these reasons that if manufacturers don't start looking to sell their products overseas, they are going to miss out on opportunities for growth and, in some cases, their very survival.

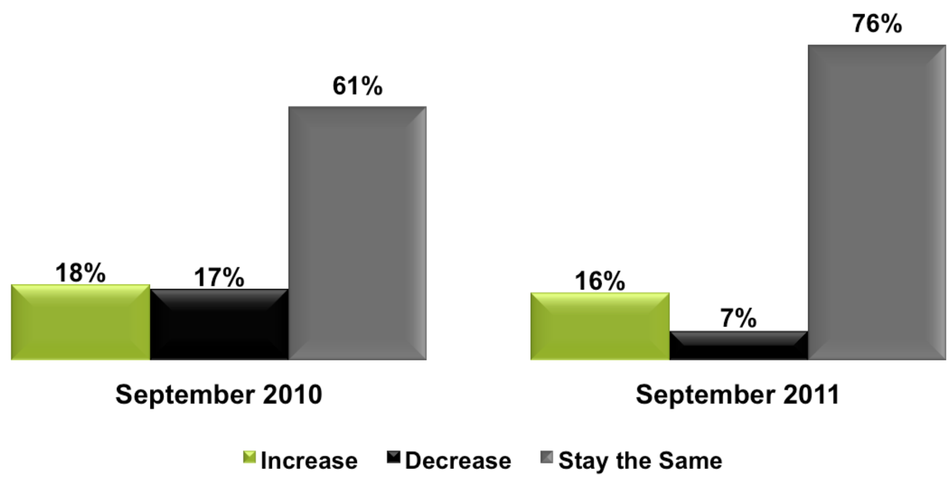
We once again took a look at exporting to see how many manufacturers are selling and shipping their products overseas. What we found is that the number of firms shipping internationally is slightly up in 2011, from 13% to 17%, but the percentage of Washington products being shipped internationally has remained virtually unchanged.

INTERNATIONAL FOOTPRINT

Most of the growth has been in exports to Western Europe, which is up 9% over 2010. There was also growth to Northern Europe and Central America.

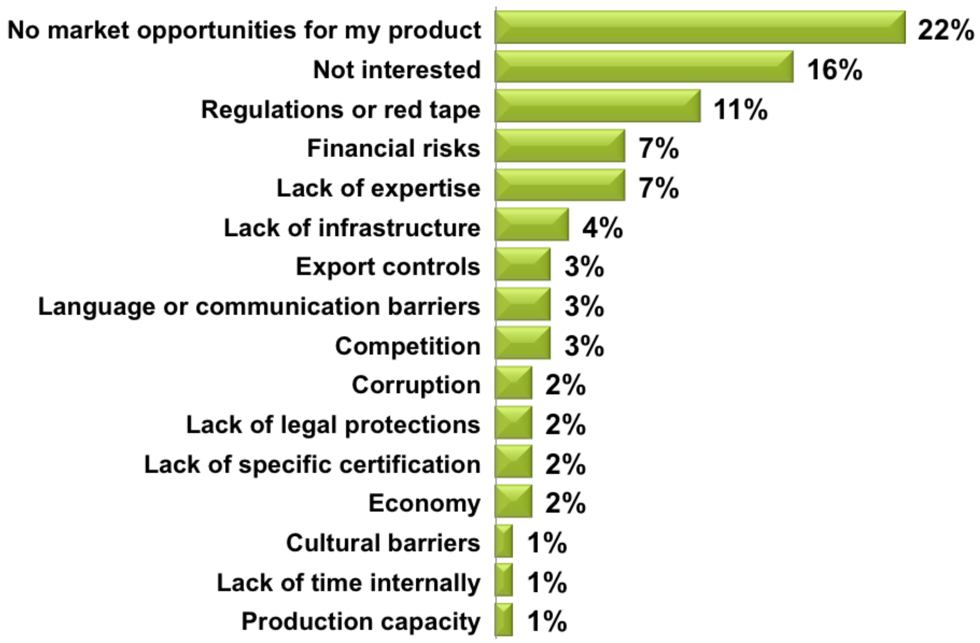
	2010	2011
Canada	42%	44%
Western Europe	17%	26%
Eastern Asia	21%	19%
Australia and New Zealand	10%	13%
Northern Europe	8%	13%
South America	9%	10%
South-Eastern Asia	8%	10%
Central America	5%	9%
Eastern Europe	12%	8%
Western Asia	6%	7%
Southern Europe	3%	7%
Caribbean	2%	6%
South-Central Asia	7%	5%

Manufacturers predict that international shipments are expected to stay steady for the next year or so, with over 90% saying that they will either stay the same or increase. There is very little decrease expected in international shipments.



INTERNATIONAL FOOTPRINT

Washington manufacturers indicated that the biggest barrier to pursuing more international business is the lack of overseas market opportunities. Regulations and red tape, financial risks and lack of expertise were also ranked as barriers.



Those particular barriers are being addressed by both federal and state government. In 2011, Washington State implemented a series of grant programs to assist in increasing exports to meet the governor's goal of increasing the state's exports by 30%. There are also several programs and agencies federally that have been tasked by the Obama Administration to help increase U.S. exports by 50% in the next 5 years. Most of these programs are focused on helping companies navigate the export process as well as helping to remove or reduce the financial risks associated with exporting.

As more companies take advantage of the vast export assistance resources available to them in Washington, many of the barriers to exporting will start to be removed. The number of manufacturers exporting, as well as the number of markets they export to, is expected to see a large increase over the next few years.

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