

2015 BDO MANUFACTURING RISKFACTOR REPORT

for Michigan



The ***BDO Manufacturing RiskFactor Report for Michigan*** examines the risk factors in the most recent 10-K filings of publicly traded U.S. manufacturers headquartered in Michigan. The factors were analyzed and ranked by order of frequency cited.

Michigan's manufacturing industry, largely propelled by robust job growth and the overall industry's ongoing renaissance, continues to accelerate. The state added nearly 15,000 manufacturing jobs between February 2014 and February 2015, a 2.1 percent increase compared with the national average of 1.7 percent, accordingly to the U.S. Department of Labor. While the sector appears to be poised for success, it faces many new risks as the industry's landscape continues to evolve. Risks related to product quality, increasing regulation and taxes, cyber security, international operations and costs of commodities are all growing concerns for Michigan's manufacturing industry.

GROWTH INCREASES INTELLECTUAL PROPERTY AND PRODUCT RISKS

The rising activity of Michigan's manufacturing sector may be heightening competition among manufacturers to develop and market new products. In fact, [Consumer Electronics Association](#) recently recognized Michigan as an Innovation Champion when reviewing states' openness and ability to welcome and foster innovation. Michigan manufacturers are concerned about protecting their products, which may explain why 74 percent cite intellectual property violations and copyright challenges. While intellectual property can yield significant competitive advantages

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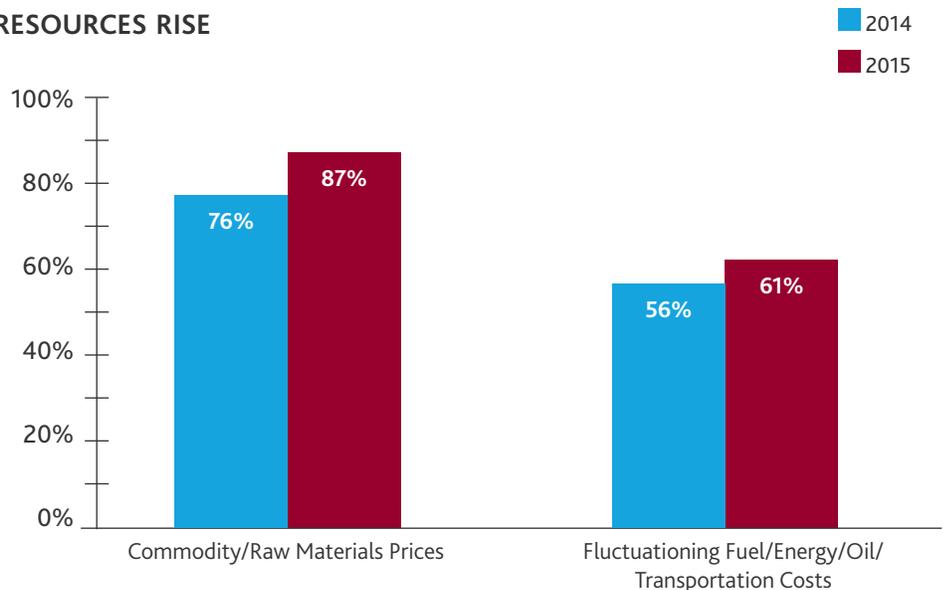
“While the manufacturing industry’s momentum benefits both the state and its workforce, it comes with increased pressure on manufacturers to deliver new and high quality products in order to stay competitive in today’s dynamic environment,” said **Fred Rozelle, Central Assurance Regional Managing Partner and Member of the BDO Manufacturing & Distribution practice**. “While Michigan’s manufacturers face great opportunity for growth, they will need to do their due diligence to ensure that the quality and protection of their products is of the highest standard.”

for manufacturers, it can also create serious issues, both domestically and overseas, where regulation may be less stringent. Additionally, product quality is top of mind for Michigan manufacturers. Damaged or defective products can lead to expensive legal proceedings, recalls and reputational damage. This may be why 77 percent of Michigan manufacturers list product quality, contamination issues and recalls as a risk, up from 74 percent in 2014.

CHANGING OIL PRICES IMPACT COST AND AVAILABILITY OF RESOURCES

The volatile oil prices of the past year are impacting manufacturers across the country, and Michigan manufacturers are no different. Lower oil prices can create opportunities and obstacles for manufacturers, depending upon their products and several other factors. Some Michigan manufacturers may benefit from increased savings due to lower energy costs. However, others may feel the blow of reduced demand if their clients in the oil and chemical industries taper their oil explorations and installations. Additionally, if oil prices were to rise quickly, it may be hard for Michigan manufacturers to offset the increase with higher prices for their customers since many have contractual agreements. This may be contributing to why 61 percent of Michigan manufacturers note fluctuations in fuel, energy, oil and transportation costs as a key concern, up from 56 percent in 2014. Closely related is risk around commodities and raw materials’ cost and availability, which 87 percent of Michigan manufacturers note is a concern, up from 76 percent last year. If certain commodities’ price or availability were to experience an unfavorable change, manufacturers’ supply chain, production schedules and finances could be negatively impacted.

CONCERNS OVER AVAILABILITY AND COSTS OF RESOURCES RISE



MOUNTING CONCERNS AROUND UNCERTAIN REGULATORY AND TAX LANDSCAPE

While House Bill 4052, which recently passed the state House and now awaits Senate action, aims to eliminate and streamline Michigan’s plethora of local regulations, it is facing strong opposition from local government officials. Couple this with two bills that now limit the state’s MEGA tax credit program, which was created to help auto companies and prevent large-scale layoffs, and it is clear to see why 100 percent of Michigan manufacturers cite federal, state and local regulations, including tax liabilities, as a risk this year, up from 94 percent in 2014. BDO’s inaugural [Tax Outlook Survey](#), which surveyed tax directors at \$1 billion-plus companies, underscores this sentiment with 45 percent of respondents noting that uncertainty around foreign, federal and state tax regulation is their top tax issue.

“As Michigan manufacturers look to manage their tax and compliance risk, they must focus on creating efficiencies that take strategic advantage of tax opportunities and reduce overall costs,” said **Matt Becker, National Tax Office Leader and Central Tax Regional Managing Partner at BDO USA, LLP**. “In Michigan’s shifting legislative environment, manufacturers must carefully consider potential resulting opportunities and obstacles as they manage their overall tax liability.”

INCREASING WORRY OVER CYBER SECURITY BREACHES AND IT ISSUES

Seventy-seven percent of Michigan’s manufacturers, whose daily work often involves IT systems, networks and services, cite breaches of technology security as a threat, up from 53 percent in 2014. This sentiment is echoed in the [2015 BDO Manufacturing RiskFactor Report](#), where 86 percent of the largest 100 publicly traded U.S. manufacturers note the same concern. With the recent hack of four million federal employees’ personal information in what may potentially be the biggest cyber security breach to date, it is clear why all industries, including Michigan’s manufacturing sector, are taking note of this rapidly growing risk. A potential attack could not only expose a manufacturer’s intellectual property, but their confidential client data, stakeholder information and trade secrets as well. Additionally, if a manufacturer’s IT systems are damaged or defective, the company can experience costly and widespread business interruptions. This may be why 65 percent of Michigan manufacturers cite the ability to maintain and implement operational infrastructure, including IT systems, as a risk, up from 62 percent last year.

Top 20 Risks for Michigan-based Manufacturers

2015 Rank	Risk Factor Cited in 10-K Filing	2015	2014
1.	Federal, State and/or Local Regulations	100%	94%
2.	Competition and Consolidation in Manufacturing	97%	100%
3.	General Economic Conditions	94%	97%
4.	Currency/Foreign Exchange Fluctuation	90%	88%
5.	U.S. and Foreign Supplier/Vendor Concerns and Distribution Disruptions	87%	88%
5t.	Threats to International Operations	87%	85%
5t.	Management of Mergers & Acquisitions	87%	85%
5t.	Less Demand for Products	87%	85%
5t.	Commodity/Raw Material Prices	87%	76%
10.	Failure to Properly Execute Business Strategy	84%	76%
11.	Legal Proceedings	81%	85%
12.	Restrictive International Trade Policies	77%	79%
12t.	Product Quality Issues/Recalls	77%	74%
12t.	Breaches of Technology Security	77%	53%
15.	Intellectual Property Violations/Challenges	74%	74%
16.	Labor Concerns; Underfunded Pensions	71%	76%
16t.	Health of The Major Industries They Serve	71%	74%
18.	Environmental Laws, Regulations and Liability	68%	76%
18t.	Access to Capital	68%	76%
20.	Ability to Innovate to Meet Changing Customer Needs	65%	68%
20t.	Loss of Key Management/New Management	65%	65%
20t.	Ability to Maintain and Implement New Operational Infrastructure, Including IT Systems	65%	62%
20t.	Natural Disasters, War, Conflicts and Terrorist Attacks	65%	62%

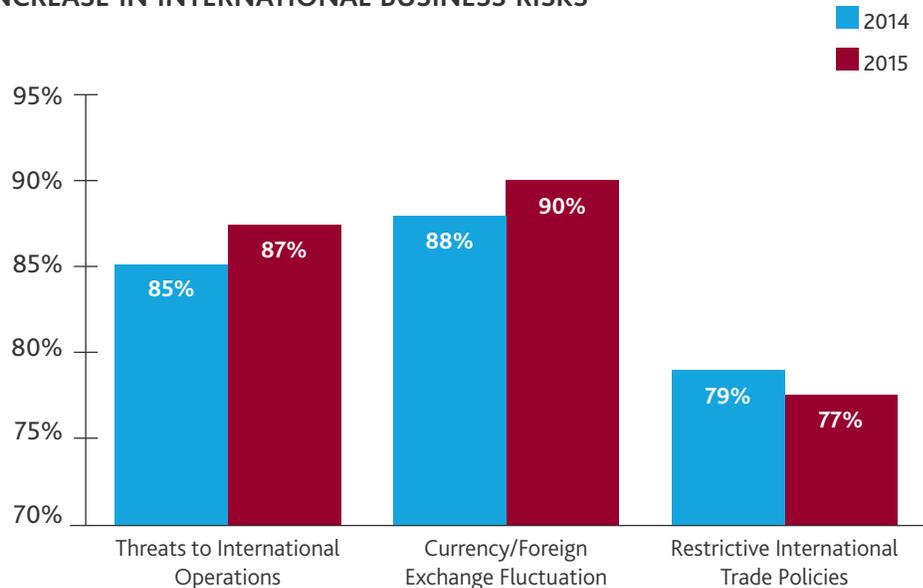
*t indicates a tie in the risk factor ranking

**2015 and 2014 percentages are out of 32 and 34 companies, respectively

CONCERNS AROUND INTERNATIONAL OPERATIONS ON THE RISE

With an increasingly interconnected global economy, many Michigan manufacturers are eager to pursue business opportunities overseas. However, with the U.S. dollar reaching 12-year highs in the first quarter of 2015, manufacturers may exercise more caution when approaching global expansion. Furthermore, foreign customers may reduce their spending, which could hamper international business and exports. This may explain why 87 percent of Michigan manufacturers cite international operations and sales as a risk, up from 85 percent in 2014. Closely related to the rising value of the U.S. dollar is concern around currency exchange fluctuations, which 90 percent of Michigan manufacturers note as a risk, up from 88 percent last year. Additionally, restrictive international trade policies are listed as a threat by 77 percent of Michigan manufacturers. These two risks have the potential to harm the profitability and longevity of domestic manufacturers' foreign operations.

INCREASE IN INTERNATIONAL BUSINESS RISKS



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BDO has been a valued business advisor to manufacturing and distribution companies for more than 100 years. We work with a variety of companies from all industrial sectors, ranging from global distributors to startup and niche manufacturing corporations, on a myriad of accounting, consulting, tax and other financial issues.

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