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BDO MANUFACTURING OUTPUT

TRANSPORTATION INFRASTRUCTURE IS THE ROAD TO MORE COMPETITIVE U.S. MANUFACTURING

Howard Sosoff, Manufacturing & Distribution practice leader at BDO USA LLP

The U.S. manufacturing industry is in the midst of a comeback. Manufacturers are gladly shifting from securing demand to meeting demand. However, reworking the U.S. transportation infrastructure is essential to the success of this progress.

Today there are more than 4 million miles of road, 600,000 bridges and 3,000 transit providers in the U.S. that have been impacted from the falling share of GDP dedicated to transportation from federal, state and local levels – while population, congestion and maintenance backlogs have increased, according to "An Economic Analysis of Transportation Infrastructure Investment," prepared this year by the National Economic Council and the President's Council of Economic Advisers.

If this lack of investment and attention persists, it could be a significant roadblock to a flourishing manufacturing industry here in the homeland.

In fact, the United States' infrastructure is so distressed that the American Society of Civil Engineers assigned it a D+ in its 2013 Report Card for America's Infrastructure – an assessment of conditions and investment needs for major types of infrastructure, including roads, bridges, water systems, ports, mass transit and the electricity grid.

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TRANSPORTATION INFRASTRUCTURE

The ongoing deterioration has not only resulted in consecutive near failing grades from the ASCE (during the last assessment period, the U.S. also received a D), but also in additional expenses for manufacturers plagued with unexpected maintenance and fuel costs resulting from the current state of the transportation infrastructure system.

The cost of congestion has increased to $121 billion, or $818 per commuter, according to the Texas A&M Transportation Institute's 2012 Annual Urban Mobility Report.

Trucks moving freight throughout the nation's roadways assume the majority of the cost of that congestion, with $27 billion derived from wasted time and diesel fuel.

FUELING A RESURGENCE

To transform this aging system into the seamless and safe network it must become for the manufacturers of today and tomorrow, it will require more than simple repairs. It will call for significant improvements, and private and public collaboration.

A clear vision will be needed on how to tackle a complex network strained by today's population and set to be flooded by future generations if it remains unchanged.

While steps are being taken to right the system, much more needs to be done before it can truly help fuel an ongoing resurgence of American manufacturing.

A few examples that signal a renewed commitment to reworking America's infrastructure include:

1. The GROW AMERICA Act:

A proposal by the Obama Administration to spend $302 billion over the next four years to make the necessary changes to the current infrastructure system to strengthen its mobility and make the country more competitive within the global marketplace. For example, $199 billion will be invested in the nation's highway system and road safety, according to the U.S. Department of Transportation.

2. Raising of the Bayonne Bridge:

A project funded by the Port Authority of New York and New Jersey that will substantially increase the distance between the bridge and the water allowing for larger container ships that previously were unable to cross under to do so. The project will open up marine terminals, including Port Newark, Elizabeth and Howland Hook in Staten Island to a greater number of ships. Currently, shippers who rely on these Eastern Seaboard ports for access to a regional transportation network have no other option but to use other smaller, less-efficient and less-environmentally friendly ships to deliver goods into the region.

3. The Deepening of PortMiami:

To prepare for the expansion of the Panama Canal, PortMiami is deepening its harbor from 44 feet to 50-52 feet and widening part of its shipping channel. This is part of its approach to increase cargo and efficiency, along with a new port tunnel to speed truck traffic and a rail link to the FCC rail yard near the airport. These post-Panamax improvements were funded from state, local and federal sources.

As more improvements like the aforementioned are made, U.S. manufacturers and the industry as a whole will enjoy a more efficient and smart infrastructure that leads to greater:

- **Marketplace Competiveness:** Through the development of a more strategic infrastructure that creates greater transportation and sourcing efficiencies, there would ultimately be a decrease in costs associated with getting goods to market. With less costs passed along to consumers, goods will be more competitively priced, encouraging greater consumer spend.

- **Job Growth:** Increased spending on infrastructure would increase employment as well as real household incomes. The National Association of Manufacturers' September 2014 Inforum Report predicts that by growing infrastructure investments the U.S. would increase jobs by approximately 1.3 million by 2015 and 1.7 million by 2017. This job growth would be experienced across all levels, from low- to high-skilled laborers, and would be realized both inside and outside of the manufacturing industry.

- **Cost Savings:** Manufacturers and consumers alike would enjoy cost-savings derived from infrastructure improvements. With the time and money savings realized through the need for less gas and vehicle maintenance, companies would be well positioned to move forward with capital investments that positively impact their businesses and bottom lines.

- **Customer Satisfaction:** As a result of a more efficient transportation structure, manufacturers would be able to escape gridlock and get goods where they need to be on time. This consistent, on-time performance would allow manufacturers to streamline warehouses and fleets, as well as strengthen customer relationships and satisfaction through shorter lead times.

As the nation's infrastructure continues to improve, so too will its manufacturers' positioning within the global marketplace. Manufacturers will be able to take advantage of an infrastructure that paves the way for greater efficiencies, ease of use and ultimately a brighter future for their businesses.

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Howard Sosoff is the Manufacturing & Distribution practice leader at BDO USA LLP. He has more than 35 years of experience in the public accounting industry, and has provided audit, accounting and business advisory services. In his business advisory role, he has consulted with companies in a wide range of industries and advised clients on accounting and reporting issues, succession planning and corporate finance, and participated in merger and acquisition negotiations.

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SPOTLIGHT ON TRANSPORTATION EQUIPMENT

Increase in Leisure Travel May Mean Bluer Skies and Smoother Sailing for Transportation Equipment Manufacturing

Consumer confidence is on the upswing. In fact, in January, the consumer confidence index climbed to 102.9, its highest level since August 2007, according to the Conference Board. This reinvigorated confidence, along with a strengthened economy, bodes well for the transportation equipment manufacturing, as consumers increasingly choose to splurge on travel, a luxury many could not previously afford due to limited financial flexibility.

Consider the following facts that confirm that Americans are putting their dollars toward traveling for pleasure:

- According to the U.S. Travel Association, direct spending on leisure travel by domestic and international travelers grew from $597 billion in 2012 to $621.4 billion in 2013.
- Americans are planning on spending 8 percent more on leisure travel in 2015 than they did in 2014 (5 percent more per trip), according to the 2015 Leisure Travel Outlook Study conducted by Choice Hotels and Newlio.com.
- The Cruise Lines International Association recently reported that 23 million travelers around the world will cruise in 2015 compared to estimated 22.1 million who did so in 2014.
- Demand for air travel rose substantially in 2014 according to the International Air Transport Association.

Contributing to the uptick in leisure travel could also be the dollars Americans continue to save at the pump. Usually one of a household's greatest expenses, fuel, for the past few months, has been hovering around the $2 mark, giving consumers more financial freedom to allocate funds toward non-essentials.

As more consumers take to roadways, airways and waterways for leisure travel the transportation equipment manufacturers are well positioned to benefit, especially the following sectors:

Aerospace: The industry continues to respond to growing demand, in part due to an increase in leisure travel. For example, Reuters reports that Boeing deliveries for 2014 increased by 12 percent over the previous year to reach 723 jets. The manufacturer has been increasing the production rate of some of its models to cater to the increased demand and in turn boosting deliveries. In 2014, the company raised the production rate of the 737 to 42 a month, and is targeting 52 a month in 2018.

Shipbuilding: With the cruising market continuing to grow, despite facing reputation-damaging incidents that could have derailed it significantly, the shipbuilding industry could be ready for a boom. According to the Cruise Line International Association, "The global fleet is now composed of 410 ships, up from 393 ships a year ago (2014). These new additions will increase fleet capacity by 37,400 passengers."

Automotive: With cheaper prices at the pump there could be more people who take to the road to reach their final destinations. With more people driving there could be an uptick in the automotive industry. Why? With increased wear and tear on vehicles there could come a demand for newer cars sooner. While following the recession, consumers began to hold on to their cars longer, with a strengthened economy and consumer confidence, individuals could now feel more financial freedom to purchase or lease new/used cars. Kelley Blue Book, the auto research company, predicts new vehicle sales in February could reach nearly 1.3 million, up 8 percent from the previous year. It would be the 12th straight month of sales growth.

If consumer confidence, along with leisure travel, continues its upward trajectory, the transportation equipment manufacturing industry could set sail on a profitable year ahead.

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TRENDING TOPICS @ NAM'S PITTSBURGH LEADERSHIP ENGAGEMENT SERIES

What's top of mind for manufacturing CEOs from Pittsburgh and the surrounding area? We recently had the opportunity to find out as we attended – and sponsored – NAM's (National Association of Manufacturers) March 11 Pittsburgh Leadership Engagement Series event. Each year, NAM hosts the series, of which we are repeat sponsors, throughout the country to offer attendees an opportunity to connect and start a dialogue with top manufacturing executives. The following are a few trends that stood out at the event.

Manufacturers Find Opportunities Abroad Appealing Due to U.S. Tax Structure

The U.S. corporate tax environment continues to be steeped in cost, complexity and uncertainty, creating ongoing challenges for manufacturers. Manufacturing enterprises continue to monitor the global competitiveness surrounding the U.S. tax structure and seek opportunities to level the field with international players.

Perception of Manufacturing Must Change to Bridge the Skills Gap

Manufacturing today is far more advanced than 20 years ago. Technology has transformed production, changing jobs and the skill sets required to fill these positions. However, many job seekers fail to realize that manufacturing today is vastly different; leaving the industry without the talent it needs to advance its future. To bridge the skills gap, the industry is working to evolve its perception through initiatives like National Manufacturing Day (Oct. 3) – a day during which local manufacturers open their doors to the public to better understand modern manufacturing.

Declining Oil Prices Could Help & Hinder Industry

While consumers are cheering for cheaper prices at the pump, manufacturers have mixed feelings about the declining costs. For some, like carmakers, it means lower energy costs and a possible boon in business, but for others, like those in the fabricated metals business that support oil and gas operators, the significant decrease has presented sales challenges that likely won't subside until those prices stabilize at a somewhat higher level.

Strengthening Dollar Could Stagnate Exports

The strengthening dollar, at its highest value in 12 years, could negatively impact the manufacturing industry, particularly exports. In response , manufacturers are taking steps now, including slowing workforce growth, to prepare for what could be a long-term challenge. However, many are hopeful that this surge in value will be more of a short blip instead of a prolonged episode that ultimately affects the broader economy.

Interested in connecting with and hearing from manufacturing CEOs about leading industry opportunities and challenges? Join us at the upcoming NAM Leadership Engagement Series events we are sponsoring, including Charlotte (April 30), Chicago (May 14), Milwaukee (date forthcoming) and Houston (date forthcoming). To learn more about the NAM Leadership Engagement Series, as well as to stay current with the series' schedule, visit http://www.nam.org/Membership/NAM-Leadership-Engagement-Series/.

Did you know…

According to the ***National Association of Manufacturers***, a targeted and long-term increase in public infrastructure investments from all public and private sources over the next 15 years will grow real GDP 1.3 percent by 2020 and 2.9 percent by 2030.

Trade Stats Express reports U.S.-manufactured goods exports reached an all-time high in 2014, surpassing $1.4 trillion for the first time.

Aerospace manufacturing has rebounded in the United States, with more than $25 billion in investments since 2012 according to **IndustryWeek**.

According to ***Wohlers Report 2014***, the worldwide revenues from 3D printing are expected to grow from $3.07 billion in 2013 to $12.8 billion by 2018, and exceed $21 billion by 2020.

An estimated $1 trillion in goods moves through the West Coast ports annually according to ***Marketplace Economy***.

BDO USA recently launched its new website. Visit us at **www.bdo.com** to read our manufacturing insights and learn more about our services to this important industry.

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PErspective in Manufacturing

Manufacturing of transportation equipment (TE)—including cars, trucks, commercial and military aircraft, ships, trains and their respective equipment—is a key economic driver worldwide. According to First Research, the global TE manufacturing industry generates approximately $4 trillion in annual revenues, with $750 billion coming from the United States. And private equity has become an increasingly popular source of funding in many TE sectors.

As traditional lending routes were squeezed during the financial crisis, the aviation industry has increasingly received funding from private equity firms such as the Carlyle Group and Cerberus Capital Management, which have provided much-needed equity, lending and leasing capital, according to legal newsletter *International Law Office*. Boeing Capital estimates there will be a $124 billion financing requirement for commercial jets in 2015 and, according to aviation newsletter *Flight Global*, new investors continue to enter the sector, including private equity, hedge funds and sovereign wealth funds.

Shipping has seen a huge influx of private equity capital over the last few years, as well. The financial crisis hit just as a boom in ship deliveries was underway, leaving lenders saddled with billions of dollars in bad debt, and forcing the industry to find alternative funding sources, according to *Bloomberg*. The subsequent post-crisis slump drew a rush of private equity investors looking to take advantage of low asset prices at the bottom of the market, including Oaktree Capital Management and Golden Tree Asset Management, which has a 4.81 percent stake in Euronav. Private equity funds poured at least $7 billion into shipping in 2014, according to industry newsletter *Hellenic Shipping News*.

However, private equity interest in the shipping sector could be waning, as the sector can be volatile and illiquid. Now that shipping assets are priced above their recent lows, the shipping industry is not drawing private equity firms to the extent it was before—and some insiders fear private equity could move on to other sectors, according to *SeaTrade Global*, a shipping newsletter.

The automotive industry—in particular General Motors, Ford and Chrysler—is seeing a level of interest from the private equity world not seen since before the Great Recession, according to the *Detroit Free Press*. This has led to some tension in the industry between activist investors who believe some automakers are hoarding cash that could be put to better use, and the longer development cycles of the automotive industry, which also has to be prepared for potential geopolitical and macroeconomic shifts.

In the defense subsector, as federal military budgets continue to shrink, consolidation and divestiture have become key trends. Some large TE firms sold off assets in 2014 to focus on their core, according to *Washington Technology*. Military contractor and jet manufacturer General Dynamics sold its Advanced Systems line of business to Canadian communications and information company MDA, and Boeing exited the commercial cybermarket and transferred its Narus technology to Symantec.

Each subsector has its own unique opportunities and challenges, but there seems to be ongoing demand for private equity financing for the manufacturing of all types of transportation equipment. What remains to be seen, however, is how long private equity will be willing and able to meet this demand.

PErspective in manufacturing is a feature examining the role of private equity in the manufacturing space.

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NAM Annual Public Affairs Conference
New Orleans

April 20-23
AeroDef Manufacturing Conference + Exposition
Dallas

April 30
NAM Leadership Engagement Series
Charlotte

MAY 2015

May 6-7
Design & Manufacturing New England
Boston

May 14
NAM Leadership Engagement Series
Chicago

JUNE 2015

June 2-3
NAM 2015 Manufacturing Summit
Washington, D.C.

June 25-26
American Food Manufacturing & Safety Summit
Dallas

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