Our Thoughts On...
the Schneider Downs

MANUFACTURERS' ECONOMIC SURVEY

2020

SCHNEIDER DOWNS
Big Thinking. Personal Focus.

INTRODUCTION

Edward Friel

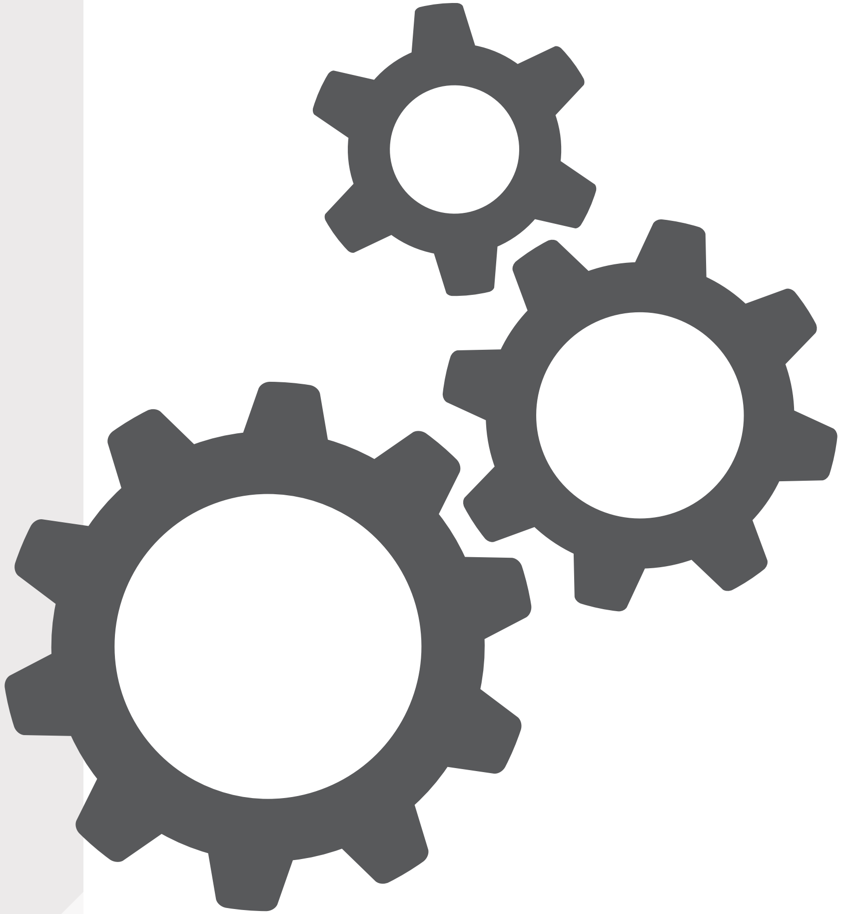
Thanks to all who participated in the 2020 Schneider Downs Manufacturing Survey. I'm pleased to report it was a great success, with response totals increasing 46% from last year.

And what a year it was. We all learned another meaning for the word *hybrid*, redefined the *new normal*, and even introduced a rather painful addition to our vocabulary: *COVID-19*. Additionally, 2020 was a presidential election year, yielding a contentious battle that dominated the airwaves and electronic media. Our survey results were definitely swayed by those two big news stories of 2020—the pandemic and the election.

Attributed to the pandemic, the downturn in the economy was the biggest challenge to manufacturers this year, as indicated by 63% of respondents. Other trials included cash flow problems (33%), a direct impact in the downturn, lack of skilled labor (33%) and an increase in labor costs (33%). This is in stark contrast to a year ago, when a downturn in the economy and cash flow problems were not deemed as significant. In 2019, the biggest challenges reported were finding skilled labor (67%) and rising labor costs (61%). Both still exist in 2020, but to a lesser degree.

Overall, respondents were enthusiastic about the future of manufacturing, with 76% replying optimistically, a number that was tempered by the anticipated results of the presidential election. Respondents believed the voting results would have the following impact on manufacturing: moderate (42%), significant (21%) and none (37%). Approximately 49% of respondents believed a win by Joe Biden would negatively impact manufacturing.

As the manufacturing sector prepares for 2021, there seem to be more questions than answers. When will the economy turn around, and is it based on ending the pandemic? Will a Biden White House positively or negatively impact the industry? While most believe the future is bright for manufacturing, there is uncertainty as to the timing of that success.



ABOUT THE SURVEY RESPONDENTS


Karen Lang

ANNUAL REVENUES

Less than $10 million	18%
$10 to $25 million	24%
$26 to $50 million	13%
$51 to $100 million	13%
$101 to $250 million	15%
More than $250 million	17%

SECTORS

Metals	30%
Industrial	28%
Assembly	13%
Consumer Goods	9%
Wholesale Distribution	7%
Plastics	5%
Chemicals	4%
Textiles	2%
Food Services	2%

EMPLOYEES

Less than 50	26%
51 to 150	18%
151 to 250	15%
251 to 500	24%
More than 500	17%

2021 WORKFORCE

"50% OF RESPONDENTS EXPECT THEIR WORKFORCE TO REMAIN THE SAME IN 2021."

BUDGET

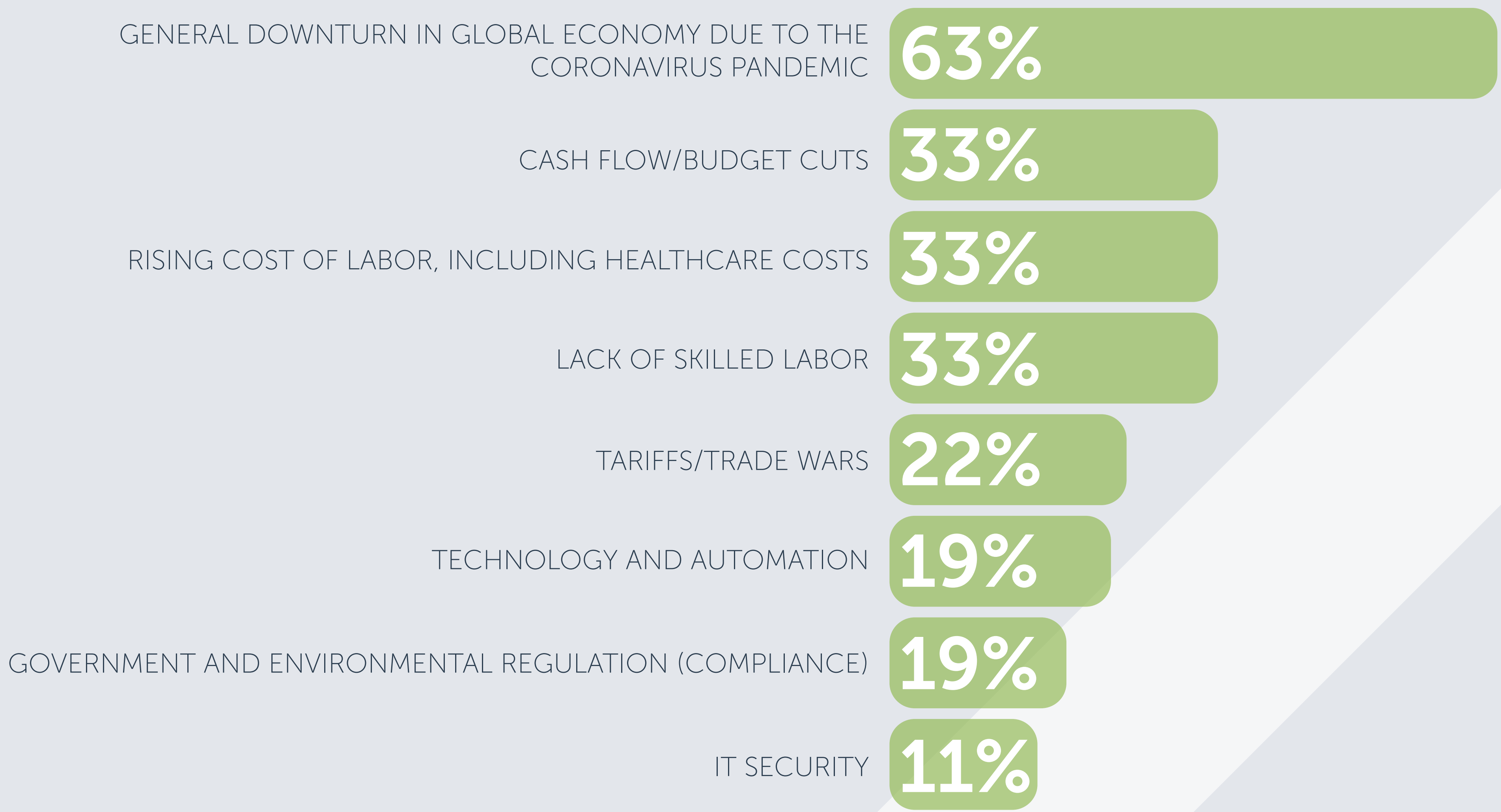
52% 2020 ACTUAL REVENUES WERE SIGNIFICANTLY BELOW 2020 BUDGET/ FORECAST.

80% IN 2021, THE MAJORITY OF THE RESPONDENTS' CAPITAL BUDGETS WILL INCREASE OR REMAIN THE SAME.

TOUGHEST CHALLENGES

SURVEY

The toughest challenges your organization is currently facing:



ELECTION RECAP

Evan Ogrodnik

SURVEY

How much, if at all, will the election impact your company's business?

Significant impact:	21%
Moderate impact:	42%
Minimal impact:	26%
No impact:	11%

49% of respondents said the Biden/Harris win will negatively impact their company's business.

As of this writing, former Vice President Joe Biden has been declared winner of the 2020 presidential election. Votes were still being collected and counted days after November 3, and there are sure to be recounts and legal challenges from President Trump before Inauguration Day. While the Democrats retained the House of Representatives, control of the Senate, however, remains undecided. Two January runoff Senate races in Georgia will determine whether there will be a balance of power in Washington.

If the Senate remains red, it's unlikely we'll see any significant tax legislation in the near term, with the exception of another economic stimulus package, which many believe is long overdue. Bipartisan support will be required for any economic or tax bill to pass through both chambers and ultimately be signed into law. That said, approximately 74% of our respondents expect tax rate increases in 2021. This seems inevitable at some point, given the additional trillions of dollars of deficit incurred this year.

President-elect Biden presented his high-level tax plans while on the campaign trail, which included raising the corporate tax rate to 28%, imposing a minimum tax on companies with in excess of $100 million of book income, raising the individual income tax rate on high-income earners to 39.6%, doubling the capital gains rate for taxpayers with greater than $1 million in income, removing the cap on the Social Security tax for wages in excess of $400,000, and reducing the estate tax exemption, among others. Mr. Biden's plans are in strong contrast to President Trump's plans of seeking a slight reduction in the corporate tax rate and further reducing tax rates for middle-class Americans.

Mr. Biden has discussed a "Made in America" tax credit for domestic businesses related to revitalization or retooling of plants and facilities, reshoring production and increasing manufacturing jobs and wages. Separately, Mr. Biden has also proposed a tax penalty on companies that move jobs overseas.

ELECTION RECAP

Final regulations on the deductibility of interest expense were issued in July 2020. Have you analyzed the tax impact of these changes to your business?

66% no

Do you anticipate tax rates increasing in 2021?

74% yes

Evan Ogrodnik

CARES Act

The global COVID-19 pandemic that began devastating the U.S. economy in mid-March led to a series of stimulus packages in an effort to maintain some sense of economic stability, the most substantive of which was the Coronavirus Aid, Relief and Economic Security (CARES) Act. The CARES Act contained numerous provisions that offered many taxpayers short-term cash flow opportunities given all the economic uncertainty. Approximately 64% of our respondents took advantage.

The CARES Act included the ability to carry back tax losses realized in tax years 2018-2020 to the five previous tax years, something the Tax Cuts and Jobs Act had removed. The CARES Act also included a job retention credit for certain employers that retained their payroll during a government-imposed shutdown or when business operations were reduced. Employers also have the ability to defer the payment of the employer-portion of Social Security taxes to future tax years.

Without question, the most widely utilized provision of the CARES Act was the Paycheck Protection Program (PPP). The PPP was a lifeline that kept the doors open to thousands of businesses across the country and was introduced to taxpayers as tax-free income, since the forgiveness of the loan itself was not considered to be a taxable event. But, on April 30, the IRS clarified that expenses funded by PPP forgiven loans were not tax-deductible, a provision confirmed by the issuance of Revenue Ruling 2020-27 in November. This, of course, created widespread consternation in that it did not appear to represent the intent nor spirit of the CARES Act. As of this writing, there is a bipartisan bill drafted that would permit these deductions. Only 14% of our respondents had budgeted for the tax impact of the non-deductibility of expenses. Many taxpayers and practitioners remain hopeful that Congress will reverse the IRS's decision and make these deductions available to taxpayers.

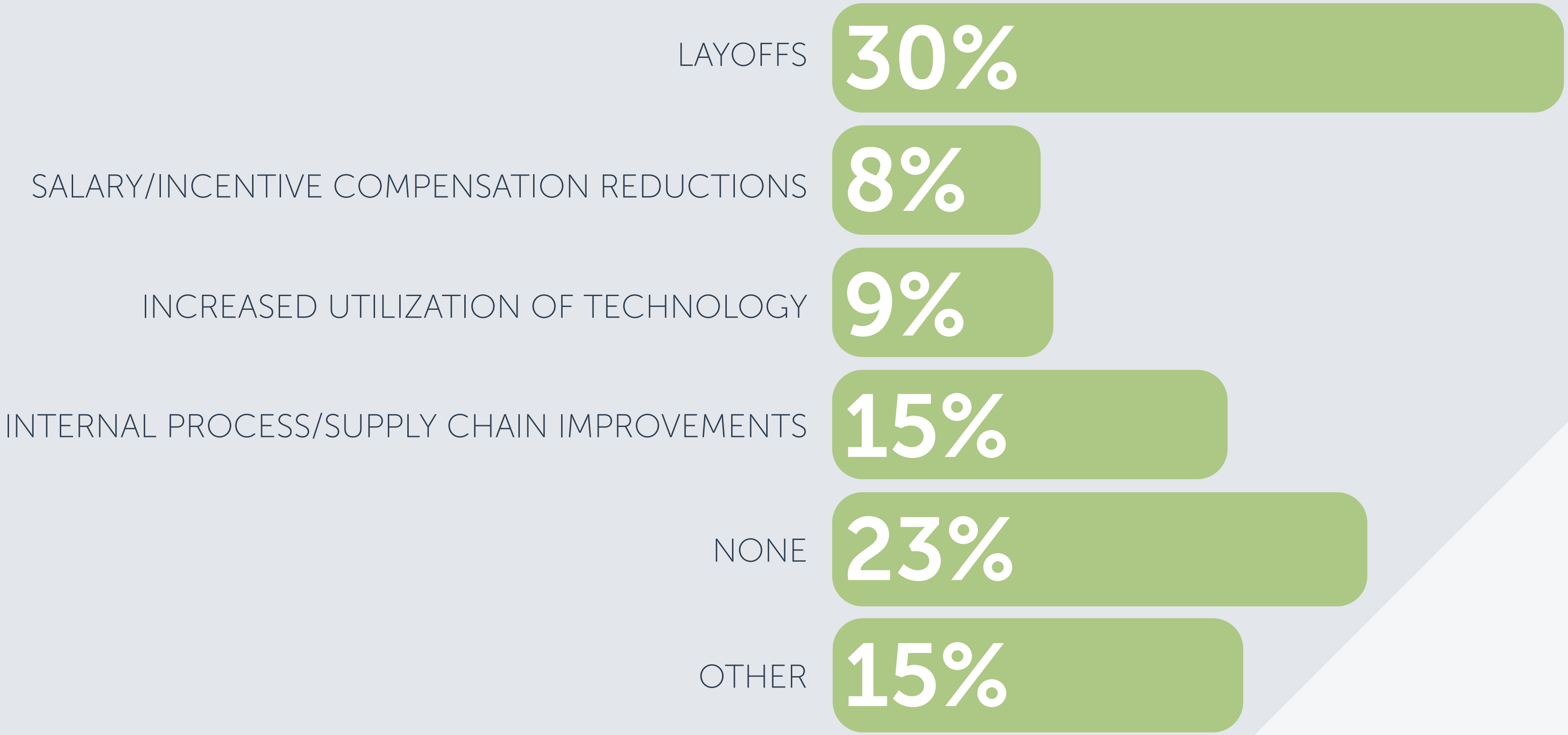
Highly leveraged and private equity-owned manufacturers will also see a significant increase in their deductible interest expense in 2020 resulting from changes in the CARES Act. The limitation is increased to 50% of adjusted taxable income (ATI), up from 30%, and taxpayers may utilize their 2019 ATI in determining their 2020 deductible interest expense, which should be helpful to businesses that were shut down by government order or whose operations were significantly reduced due to the pandemic. Additionally, final regulations issued in July 2020 permit manufacturers to include cost of goods sold depreciation in their ATI calculation. Only 34% of our respondents had analyzed the impact of the interest changes to their businesses. Manufacturers should remain mindful of the looming change beginning in tax year 2022, at which point the limitation for deductible interest expense will be 30% of earnings before interest and taxes (no addback for depreciation and amortization).

Brian Reitz

COVID-19 PANDEMIC

SURVEY

What cost cutting techniques has your company adopted during the pandemic?



Has the pandemic caused you to make permanent changes to your operations? 57% no

CARES ACT RELIEF

Brian Matthews

SURVEY

Did you or your business take advantage of any tax relief pursuant to the CARES Act enacted on March 27, 2020 or other relief that became available?

64% yes

Which program(s) did you participate in?

Paycheck Protection Program (PPP) **82%**
Employer Payroll Tax Deferral **29%**
Employee Retention Credit **15%**
Employee Payroll Tax Deferral **9%**
Emergency Injury Disaster Loan **6%**

During these unprecedented times, no business has remained unaffected, and the impact on the manufacturing industry has been significant according to our survey respondents. Over 50% acknowledged that their 2020 actuals will be significantly below 2020 forecasts. Thankfully, there's been legislative response to provide economic relief to Americans and American businesses, including the Families First Coronavirus Response Act (FFCRA) and the Coronavirus Aid, Relief and Economic Security Act (CARES Act). While the FFCRA was mostly focused on policies and procedures for certain programs in response to the COVID-19 pandemic, the CARES Act provided very necessary economic relief to businesses of all industries.

The CARES Act provided relief to businesses through multiple income tax provision revisions directly related to the 2017 Tax Cuts and Jobs Act, including modifications to the net operating loss carry-back rules, acceleration of corporate AMT credit utilization and an employee retention credit. Many businesses are analyzing these provisions to assess the impact on their business.

CARES ACT RELIEF

Was your PPP loan greater than $2 million?

61% no

Indicate all that apply to your PPP loan:

75% Our company anticipates receiving full forgiveness of the loan

54% Our company has not yet applied for forgiveness

32% Our company has applied for forgiveness

14% Our company has budgeted for the tax impact with the loss of PPP-funded deduction

11% Our company anticipates having to repay all or a portion of the loan

Brian Matthews

A popular relief program under the CARES Act that was available to businesses and manufacturers that met eligibly requirements was the Paycheck Protection Program (PPP). Over half of our respondents received loan proceeds under PPP, the intent of which was to keep America employed, including its manufacturing workers. If businesses used the loan proceeds on eligible costs, a portion or all of the loan would be forgiven, which was attractive to many businesses. As of the date of our survey, the application period for a PPP loan had passed, but 75% of those that had received loans were anticipating receiving full forgiveness.

Relief for manufacturing helped keep the industry on track, but some of our respondents believe it's going to take between one and two years to completely recover, while others have seen some recovery already.

BUSINESS RECOVERY

SURVEY

Was your business shut down by a government mandate as a result of the pandemic?

68% no
19% yes - under 1 month
13% yes - over 1 month

What do you think the biggest challenge will be to reach the business levels prior to the pandemic?
TOP THREE RESPONSES

FINDING NEW CUSTOMERS TO REPLACE THOSE THAT HAVE BEEN LOST	45%
MAINTAINING COMPLIANCE WITH OSHA, CDC AND DEPARTMENT OF HEALTH SANITATION AND SAFETY STANDARDS FOR OUR WORK FORCE	23%
FINDING NEW SUPPLIERS TO REPLACE THOSE THAT HAVE BEEN LOST	17%

When do you think your company will see full recovery from the results of the pandemic?

27%	We have started to see some recovery
11%	Six months
45%	One to two years
15%	Two to five years
2%	We will never fully recover

BUSINESS RECOVERY

Michael Hart

According to studies performed by McKinsey Global Institute and Oxford Economics, it could take five years or longer for businesses to recover to pre-COVID economic levels. With banks' ability to provide financial relief dwindling and COVID cases increasing, consider the following actions to be proactive and help guide you through these uncertain times.

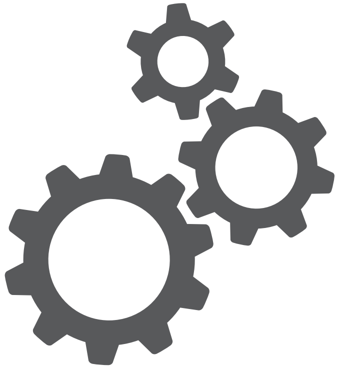
Constantly update forecasts and develop contingency plans. Create rolling forecasts that incorporate new data and identify areas of risk, particularly with regard to cash flow. Develop trigger points to take further action based on defined business results. Don't forget the added cost of complying with new hygiene and safety protocols. The cost of cleaning supplies, disinfectant wipes and labor to clean the workplace needs to be budgeted and accounted for.

Aggressively address expenses. Yes, you already cut expenses. But it's easier to cut too much and then restore expenses than it is to not cut enough and have to implement several rounds of reductions. Also, be creative with compensation. If you're asking employees to share the short-term pain, let them also participate in the upside, through profit-sharing programs.

Explore new product lines and services. Customer demand is changing. A client's sales numbers for existing products are down 60%-80%. Instead of waiting, they reacted and added a new product line, which now comprises 35% of current sales. Determine how your company can adapt to fulfill changing demand.

Get analytical. A deep dive into your company's data could provide significant profitability improvement opportunities. Areas where analytics can help decision-making include customer, product and order profitability, price and cost performance, and inventory maintenance.

Divest of excess assets. Optimize inventory levels to match demand. Part ways with unnecessary equipment or other assets. While you may not receive optimal prices, cash is king right now.



Shorten your cash cycle. Collect faster and pay slower. This may be easier said than done, but you should have a plan to work with customers and vendors to maximize your cash cycle. A client of mine is currently asking for 50% payment upfront for all new customers.

Evaluate financial structure. Long-term assets should be paired with term debt or a mortgage. Working capital assets should be matched with a line of credit. Confirm that your balance sheet is correctly structured and make sure any line of credit is large enough to bridge potential cash gaps.

CYBERSECURITY

SURVEY

Do you have employees who are working remotely during the pandemic?	79% yes
Are you confident your remote workforce is taking the appropriate cybersecurity precautions?	67% yes

CYBERSECURITY

Mark Sarver

The forced work-from-home reality that we've all been thrust into during the pandemic brings with it an increase in cybersecurity risk. The "new normal" has simply become normal as we continue to adapt to remote accommodations. A recent survey reports that nearly 51% of employees in the United States are working remotely and predicts that even in a post-pandemic environment the remote workforce will be 30%, nearly triple the amount reported pre-pandemic.

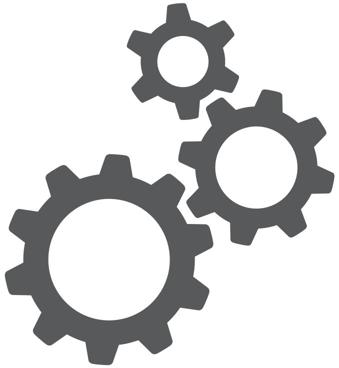
While working remotely is not in and of itself dangerous, changes to normal policy or the relaxing of normal standards are what bring about additional cybersecurity risks. Here are some best practices from our team to help keep your workforce and data secure in remote environments.

Enforce multi-factor authentication. Many attacks involve a threat that spreads from compromised and unprotected accounts. Multi-factor authentication (MFA) usually consists of a password and code provided by an app or physical device. There are number of apps that provide this protection, as well as older methods that send codes to a physical tokens provided to users.

Install patches and updates. Software updates and security patches are critical in keeping your information secure and operating system current, in addition to reducing vulnerabilities, which is why choosing to click on "install updates now" is so important, both on work and personal devices.

Avoid COVID-19 scams. The pandemic provided a fresh coat of paint for some of the most common attack methods including phishing, smishing and web-based malware attacks. Sharing the FTC Coronavirus website or our COVID-19 scam infographic are good starting points to educate your end users on identifying and avoiding these traps.

Protect your users. Good intentions do not protect your organization. Assume that someone at some point in time will click on a malicious link. Implement appropriate defense measures, because it will happen. Protect inboxes by using an advanced anti-phishing/antispam email filter and protect endpoints with a heuristic based antivirus solution.



ABOUT THE SCHNEIDER DOWNS MANUFACTURING INDUSTRY GROUP

Schneider Downs provides accounting, tax and business advisory services to the manufacturing industry in Western Pennsylvania, Central Ohio, Washington D.C. and around the world. Our team of business advisors works with a range of manufacturers from high-tech startups to publicly traded industrial manufacturers.

Our Manufacturing Industry Group helps our clients streamline operations, improve internal controls, maximize tax benefits and grow profitability. Our dedicated team of professionals has the experience and knowledge to work with your manufacturing organization to develop specific solutions to achieve your business goals.

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