MANUFACTURING MATTERS

A BDO SNAPSHOT OF WHAT TO EXPECT IN 2012

BDO

YOUR COUNTRY NEEDS YOU!

After many years of neglect we seem to have realised that a strong and vibrant manufacturing sector is fundamental to the UK economy. Given the decline of the past 30 years the task of rebuilding the manufacturing sector will not be easy and will take years – and we know that some commentators feel that the erosion of the sector and our skills base makes significant rebuilding impossible. But we think that the renewed focus on manufacturing is a good thing. For 2012 we expect that the Government will continue to focus on the rebuilding of manufacturing and we think that this will offer some level of support. But we would like to see the Government develop a clearer and more explicit medium to long term framework/strategy for the sector with absolute clarity on how important manufacturing is to the economy and how it is to be supported to enable long term growth.

THERE IS NO DOUBT THAT 2012 WILL BE EXTREMELY CHALLENGING

OUR MAJOR INTERNATIONAL MARKETS ARE IN ECONOMIC CRISIS

The economies of Europe, the USA and the UK are in a mess and the huge reduction in demand from our largest markets as they battle through political and economic turmoil will impact the UK manufacturing sector. Although the latest forecasts from the EEF show expectations of growth for 2012 (manufacturing is ahead of the economy in general) the latest UK and global PMI indices are showing a significant deterioration in confidence. In addition, the huge pressures on sovereign debt and bank debt and balance sheets will continue to make access to growth capital very difficult, particularly for SMEs. Assuming Eurozone survival (if it does not all bets are off!) we think that the ongoing flow of bad news from key economies and markets and the lack of access to capital will make 2012 a very difficult year indeed for most manufacturers. It could be a year to keep a very careful watch on cash flow, working capital and funding facilities.

RECRUITMENT AND INVESTMENT WILL DECLINE/REVERSE

The balance of firms taking on new workers has continued to fall throughout 2011. In Q4 2011, the balance of companies planning to take on new workers in the next three months fell to 5% – down from 12% on the previous quarter and a high of 30% in Q1. However, the spend freeze is not universal: some companies will continue to invest in R&D in 2012: Caterpillar has just announced plans to invest £50m in its UK manufacturing facilities, JCB is to invest £31m in designing and manufacturing the next generation of heavy duty diesel engines and Michelin is to invest £50m in its two UK manufacturing sites. However, smaller firms will need reassurance to invest in growth in 2012: a recent CBI survey showed that SME firms were planning to cut spend on plant and equipment next year and the number who were planning to invest only in replacing existing capital in the year ahead was at the highest level (58%) since the survey began in 1988. Overall, despite pockets of good news, we expect the factors noted above will make it very difficult to see positive investment and recruitment through 2012 and we anticipate some manufacturers will unfortunately be likely to need to shed labour to keep in balance.

5%

In Q4 2011, the balance of companies planning to take on new workers in the next three months fell to 5% – down from 12% on the previous quarter and a high of 30% in Q1.

BUT IT MAY NOT BE ALL DOOM AND GLOOM

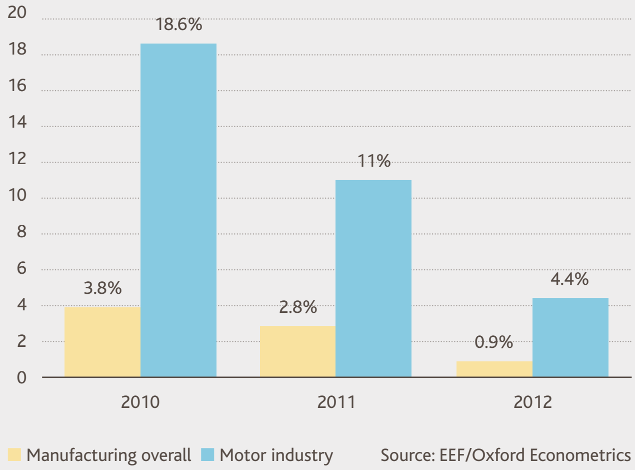
THE AUTOMOTIVE RENAISSANCE WILL CONTINUE

Who says that the UK automotive sector is dead? The motor industry is predicted to see an 11% rise in output in 2011 and expects further growth (albeit of "only" 4.%) in 2012. As UK automotive supports a huge and mostly UK supply chain this continuing good news should help underpin a lot of UK manufacturing order books through 2012. Jaguar Land Rover, Aston Martin and Lotus have had huge export success in 2011 and expect this trend to continue through 2012. In addition, Nissan UK has seen huge export success with its Juke and Qashqai models, and expects this success to continue as it starts to produce the LEAF electric car from 2013 onwards. Despite the general economic outlook we think the quality products in UK automotive give it a good chance to continue its bounce back – albeit from a very low position – and be one of the core foundation sectors for UK manufacturing in 2012.

EXPORTS WILL CONTINUE TO UNDERPIN THE SECTOR

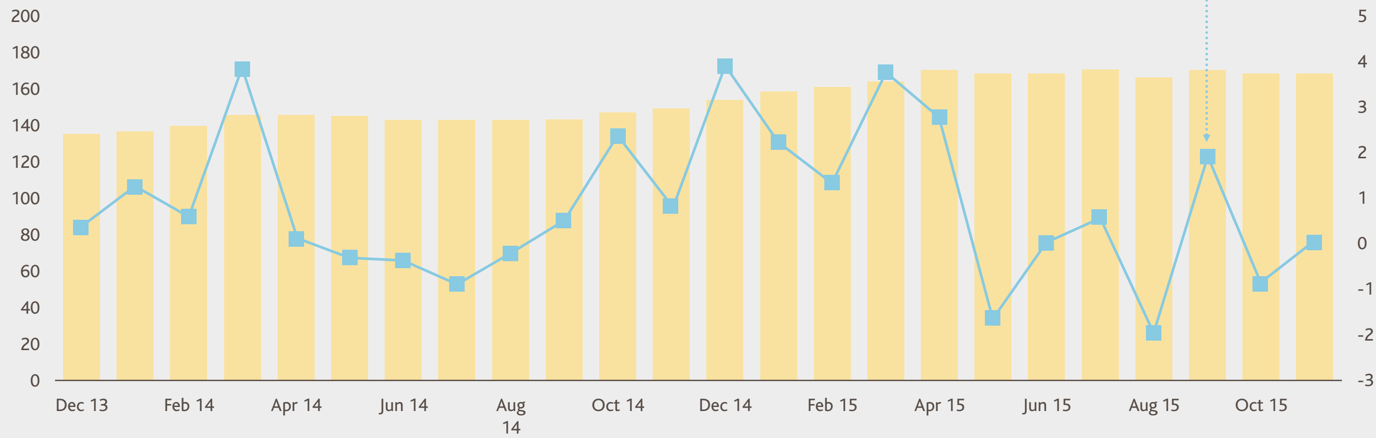
In a world where the number of global giants is increasing, the UK provides a very small market for our manufacturers which means exporting is becoming ever more important. 2011 ended relatively positively for the sector with a balance of 10% of manufacturers witnessing growth in overseas orders and the EEF reporting that emerging markets continue to offer "solid prospects for growth". For 2012, we think Europe and the USA will continue to provide our foundation markets despite the economic turmoil, but companies looking for export growth and significant new market opportunities should focus on the rapidly emerging giants (China, India and Brazil) in addition to looking towards the fast developing new emerging markets such as the "CIVETS" (Colombia, Indonesia, Vietnam, Egypt, Turkey and South Africa).

SECTOR FORECASTS (% CHANGE YEAR ON YEAR)



Input prices are showing first signs of decreasing and prices are no longer spiralling to the extent seen in 2010 to early 2011.

NET SECTOR INPUT PRICE INDEX



Source: National Statistics

INNOVATION WILL REMAIN A CORE STRENGTH

There have been a number of recent Government initiatives which have the potential to spur innovation: the R&D tax credit system will be significantly reformed, most notably increasing the tax relief from £200 to £225 for each £100 of R&D activity and the introduction of the new "patent box" scheme which reduces the rate of corporation tax on income derived from patents to 10%. In addition, the Government has recently announced the availability of a new £125m fund to encourage growth in established UK advanced manufacturing supply sectors such as aerospace, automotive and chemicals. Manufacturers have, quite rightly in our view, experienced difficulty in understanding and accessing the raft of initiatives established in the past year or so. However, we are encouraged by the new measures and the benefits they can bring to manufacturers in 2012 and we would urge companies to increase their awareness of them and use the various support schemes available to them where appropriate.

INPUT PRICES WILL BE VOLATILE BUT MAY EASE

After a period that has seen huge increases, commodity prices are finally showing signs of balance or reduction which should ease margin pressures for manufacturers. In November 2011, manufacturers reported lower costs of alloys, chemicals, commodities, plastics and steel with some of these savings already passed on at the factory gate. In addition, the problems in the US and Europe and the slight slowdown in the growth of the emerging giants may slow or reduce (even if only for a short time) the demand for commodities and energy. However, whilst we think that 2012 may show a bit more stability, demand and pricing for commodities and energy is likely to remain volatile. We think manufacturers will continue to focus on sustainability as a business tool as much as a CSR position, using it to redesign manufacturing processes to become more resource and energy efficient.

£125m

The Government have recently announced the availability of a new £125m fund to encourage growth in established UK advanced manufacturing supply sectors such as aerospace, automotive and chemicals.

ABOUT BDO

BDO is the award-winning UK member firm of the BDO international network, the world's fifth largest accountancy organisation, with more than 1,000 offices in over 100 countries*.

Most Manufacturing clients are active internationally. So are we and in regions that are important to Manufacturing. Most are involved in acquisitions, public offerings and major capital projects. We have great experience in these areas. Our manufacturing clients have regulatory, reporting and legislative issues. We bring sector expertise and a proactive approach to assist. Our clients want to mitigate and manage tax liabilities globally. Our international specialist teams have the skills to assist. Manufacturing remains one of the key industries of the UK economy. We are delighted to be able to play an active role in supporting the businesses that operate in this vibrant, changing and challenging sector.

HOW WE CAN HELP YOU

If you would like further information about this publication or our specialist knowledge of the manufacturing sector, please contact:

Tom Lawton
Partner, Head of Manufacturing
tom.lawton@bdo.co.uk
+44 (0) 121 352 6372

Alternatively contact your local BDO business centre:

BIRMINGHAM
tom.lawton@bdo.co.uk
0121 352 6372

BRISTOL
jim.brown@bdo.co.uk
0117 930 1511

GLASGOW
gavin.hunter@bdo.co.uk
0141 249 5255

LEEDS
jason.whitworth@bdo.co.uk
0113 204 1237

LONDON
marc.reinecke@bdo.co.uk
020 7893 3159

MANCHESTER
philip.storer@bdo.co.uk
0161 817 7510

NORTHERN IRELAND
francis.martin@bdo.co.uk
02890 439009

READING
chris.pooles@bdo.co.uk
0118 925 4412

SOUTHAMPTON
paul.duckworth@bdo.co.uk
023 8088 1867

EASTERN REGION: CAMBRIDGE, CHELMSFORD, HATFIELD
jamie.cassell@bdo.co.uk
01707 255847

SOUTHERN REGION: EPSOM, GATWICK
kevin.cook@bdo.co.uk
01372 754557

www.bdo.co.uk

*Including exclusive alliances of BDO Member Firms.

This document is printed on 9lives 80, a paper containing 80 per cent recycled fibre and 20 per cent virgin Totally Chlorine Free (TCF) fibre sourced from sustainable forests. 9lives 80 is produced by an ISO 14001 accredited supplier.