UHY LLP Certified Public Accountants

MANUFACTURING INSIDER



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ARE YOU PREPARED TO SELL YOUR BUSINESS?

Many business owners spend most of their lives intricately planning every detail of their business, from sales calls to processing and manufacturing to post-sale support, all the way to the finance and accounting function. Despite all of the operational and financial planning, most business owners are left completely unprepared for the most important sale of their life – the sale of their business. Although many factors of an owner's business may be outside of their control, there are several steps that a business owner can take to help ensure a successful exit.

- **Create a Management Team** – Any buyer needs to clearly understand the roles filled by each member of the management team. The owner should be able to plainly convey to a buyer who is responsible for the key functional areas of finance and accounting, sales and marketing, manufacturing, information technology, and overall management of the company. The critical question any buyer asks is "Can the company survive if the owner is no longer active in the business?" If the answer is yes, then the owner has cleared one of the first major hurdles in buyer scrutiny. If not, then the business owner should assess the team and fill the appropriate gaps. Often times, owners are concerned that if key management team members learn about a proposed sale, those individuals may pursue other opportunities. While guarantees can never be made that some executives will not leave the business, transaction bonuses or stay bonuses are excellent tools to mitigate this risk. The bottom line is that a business that "runs itself" without intense owner input helps to maximize value.

- **Prepare for a Sale** – During any sale process, it is the responsibility of the business owners and their advisors to gather the necessary documentation required for the acquirer to complete due diligence. Examples of these items include various functional areas including legal (e.g., stock records, shareholder agreements, loan agreements), financial (audited financial statements, internal monthly financial statements, fixed asset listings, tax returns), and operational (customer / supply contracts, royalty agreements, insurance policies,

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The next level of service

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employee benefit plans, and collective bargaining agreements). Importantly, a certain level of "reverse due diligence" must be performed on this documentation prior to supplying to the acquirer, and any inconsistencies, inaccuracies, or undue delay in producing requested data may lead to the acquirer putting the deal on-hold, reducing the purchase price, or even ultimately walking away from the deal.

- **Understand Your Company's Position in the Business Cycle** – Apart from industry-specific growth and individual company attributes such as customer concentration, gross margins, and top-line growth, the overall business cycle plays a key role in determining the enterprise value of a business. Most buyers will want to see that management has been operating a company at a relatively higher level of earnings for a year or two before the sale, as acquirers tend to discredit "hockey stick" projections. In addition, the business owner should be able to make the case that this elevated level of sales and earnings should be expected to continue for the foreseeable future, which can be done by tying top-line projections to the company's order book or linking sales projections to forecasted volumes, as is common in the automotive industry.

- **Understand Structure & Tax Impact** – Are all offers created equally? Absolutely not! In addition to focusing on the gross consideration (i.e., purchase price), business owners and their advisors must consider items such as the type of acquisition (stock vs. asset), form of consideration (cash, seller's note, earn-out, etc.), working capital adjustments, escrows, caps and baskets, indemnification provisions, and representations and warranties. If improperly structured, an apparently great cash offer could subject the business owner to significant and unexpected post-closing tax and legal liabilities.

- **Maintain Your Focus** – Many business owners who go through the process of selling their company feel as though it is a second job due to the amount of time and effort involved. Because of this, often times, the management team loses focus and financial and other operational metrics slip. Nothing is more damaging to a sale process than a company's failure to meet projected performance. The importance of hiring a qualified investment banker cannot be understated as it is their responsibility to carry the load of moving the transaction forward.

Each transaction is unique and presents its own distinct set of circumstances, however, good companies can become highly sought-after opportunities by both private equity and strategic buyers by following these guidelines.

Aaron Witalec, Managing Director
(Detroit, MI)

AUTO SALES FORECAST LOWERED FOR NEXT DECADE

LMC Automotive has revised the forecast for auto sales in the US for the entire forecast horizon based on the recent plateauing of year-on-year sales growth, combined with growing economic and political risk in the US and globally, potentially impacting trade, the US economy and consumer confidence. The full press release is below:

Issued July 2016

LMC Automotive cuts forecast for US auto sales: Revision projects first contraction in light vehicles sales since 2009 recession, but overall volume level remains strong

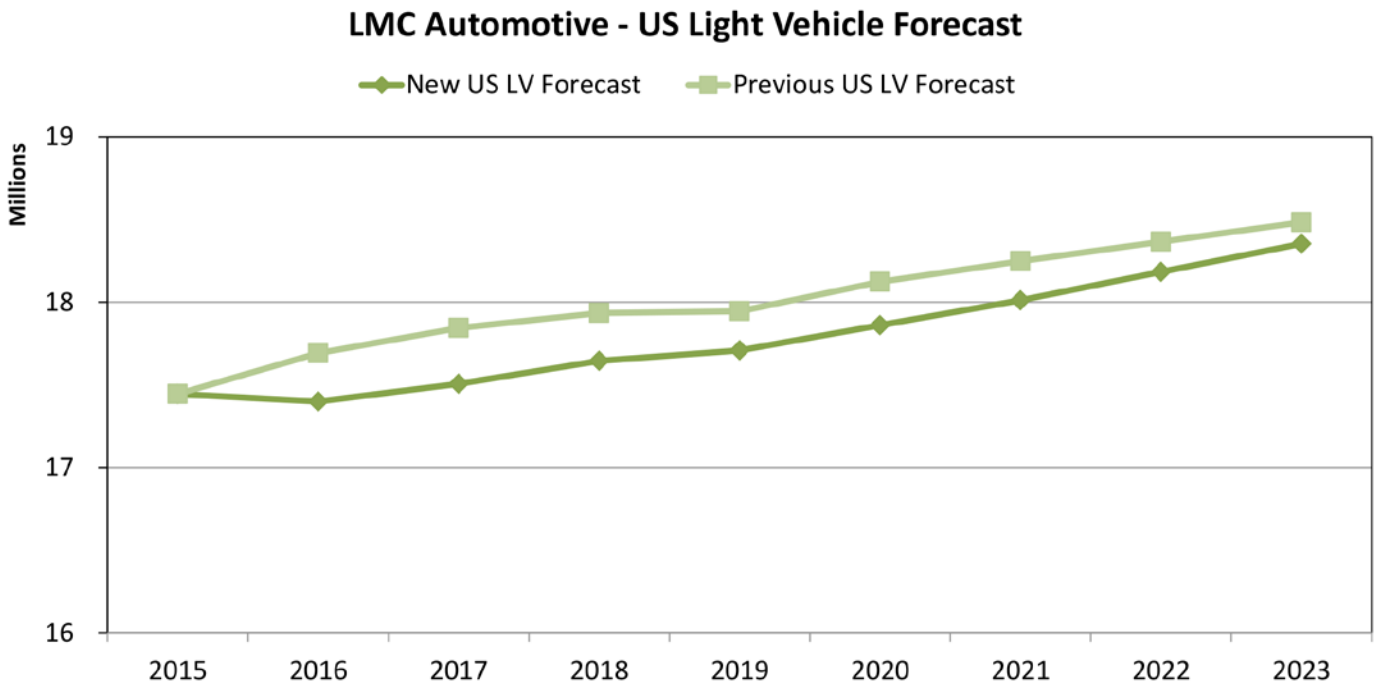
LMC Automotive has revised the forecast for auto sales in the US for the entire forecast horizon (2016-2023) based on the recent plateauing of year-on-year sales growth, combined with growing economic and political risk in the US and globally, potentially impacting trade, the US economy and consumer confidence.

The forecast reduction averages nearly 250,000 units each year from 2016-2023, with a larger reduction in 2016 and 2017. Specific to 2016, the US forecast was cut by 300,000 units to 17.4 million units from 17.7 million units, a -1.7% reduction. This represents a 0.3% contraction or about 40,000 units lower than the record level of 17.44 million units in 2015. Nearly all of this reduction was made to retail sales, bringing the forecast for retail light vehicle sales down to 14.0 million units from 14.3 million units previously.

Our latest forecast now reflects the reality that the growth track that the US market has been on since 2009 has stalled and appears to be levelling off, but it does not necessarily signal that further contractions or an automotive recession is imminent," said Jeff Schuster, Senior Vice President Forecasting at LMC Automotive.

"Volume and growth risks in the second half of 2016 are running higher, as monthly US market results will be compared to a very strong second half of 2015 and as the global economy grapples with the impact of the Brexit result and the unknown of the upcoming US election".

While the strong recovery and growth since the recession of 2009 may be coming to an end, LMC Automotive continues to expect the US automotive market to remain solid over the forecast horizon, with volume forecasts holding at the mid-17 million unit level before slowly climbing past 18 million units by 2022. Underpinning our automotive outlook is the expectation that the US economy will continue to expand, averaging at least 2% GDP growth throughout the forecast period, something which is certainly achievable.



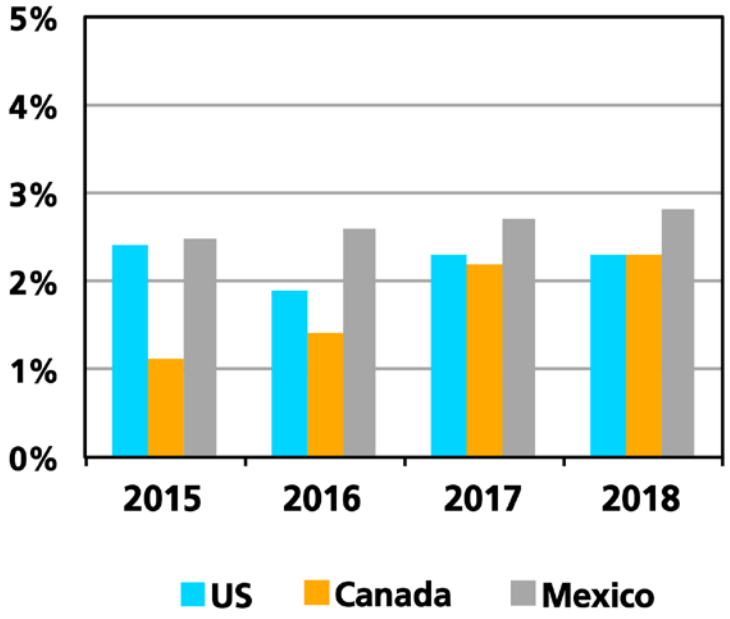
NORTH AMERICAN AUTOMOTIVE PRODUCTION FORECAST SUMMARY - Q2 2016

Summary includes economic outlook, light vehicle sales outlook, current production drivers, production capacity and long-term trend, model launches and investments.

NORTH AMERICA ECONOMIC OUTLOOK

- **US** – GDP growth is being held at 1.9% growth, but risks remain given the volatility in the financial markets following the UK's decision to exit the European Union. Consumer spending growth in 2016 was revised upward by 0.2%.
- **Canada** – Real GDP growth in Canada was strong in Q1, advancing by 2.4% annualized. Net exports and consumer spending led the charge, while final domestic demand grew by 1.3% – the strongest since Q4 2014. Ongoing employment gains, subdued inflation, and low interest rates should support consumer spending growth at a moderate pace.
- **Mexico** - The longer-term outlook in Mexico remains just below the 3.0% level. Much of the current expectation rides on the outlook for the US economy, a key partner for trade.

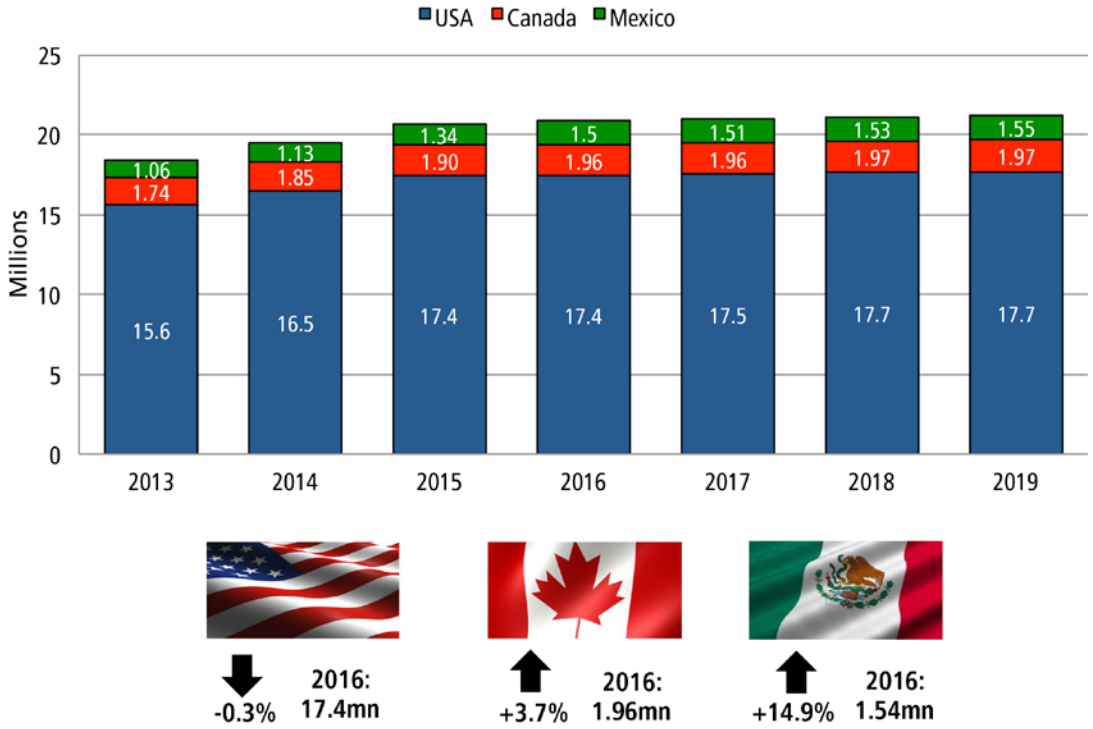
GDP GROWTH



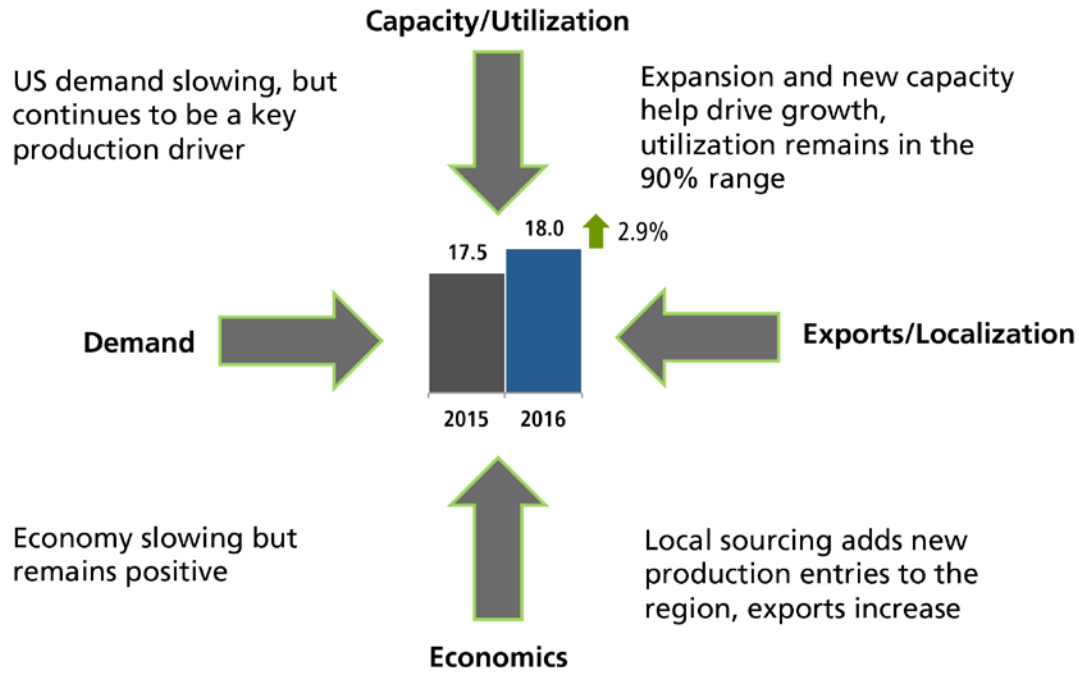
		2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
United States	GDP Growth	1.5%	2.4%	2.4%	1.9%	2.3%	2.3%	2.1%	2.1%	2.0%	2.0%	1.9%
	Consumer Spending Growth	1.7%	2.7%	3.1%	2.7%	2.5%	2.3%	2.1%	2.0%	2.0%	1.9%	1.9%
	Short-term Interest Rate	0.3%	0.2%	0.3%	0.8%	1.5%	2.0%	2.5%	3.0%	3.4%	3.5%	3.5%
	Unemployment Level	7.4%	6.2%	5.3%	4.8%	4.6%	4.7%	4.7%	4.8%	4.8%	4.8%	4.8%
Canada	GDP Growth	2.0%	2.5%	1.1%	1.4%	2.2%	2.3%	2.2%	2.1%	2.0%	2.0%	2.0%
	Consumer Spending Growth	2.5%	2.5%	1.9%	1.6%	1.5%	2.0%	2.1%	2.1%	2.0%	2.0%	2.0%
Mexico	GDP Growth	1.6%	2.3%	2.5%	2.6%	2.7%	2.8%	2.8%	2.8%	2.9%	3.0%	3.0%
	Consumer Spending Growth	2.6%	1.8%	3.1%	3.5%	2.9%	2.6%	2.7%	2.8%	2.9%	2.9%	2.9%

Source: Oxford Economics, LMC Automotive

NORTH AMERICA LIGHT VEHICLE SALES OUTLOOK

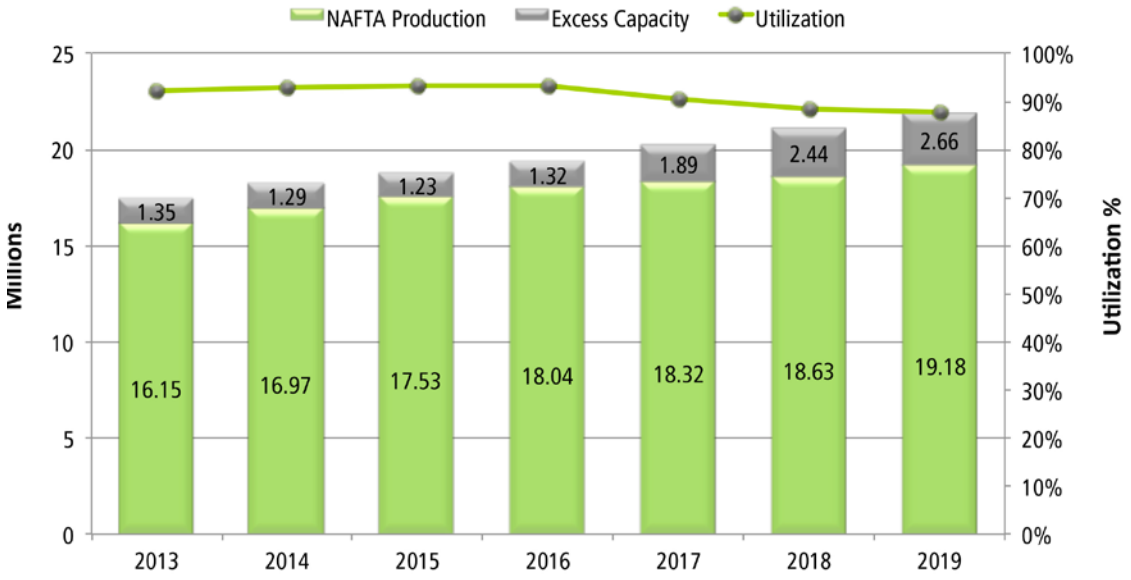


CURRENT NA PRODUCTION DRIVERS



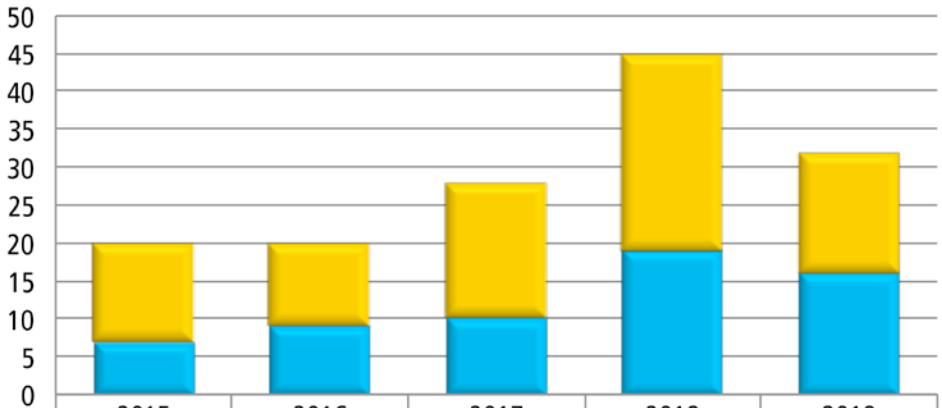
Source: LMC Automotive

NORTH AMERICA PRODUCTION AND CAPACITY LONG-TERM TREND



- Demand driven growth adds stability layer
- Localization and exports drive production expansion - utilization remains 90%

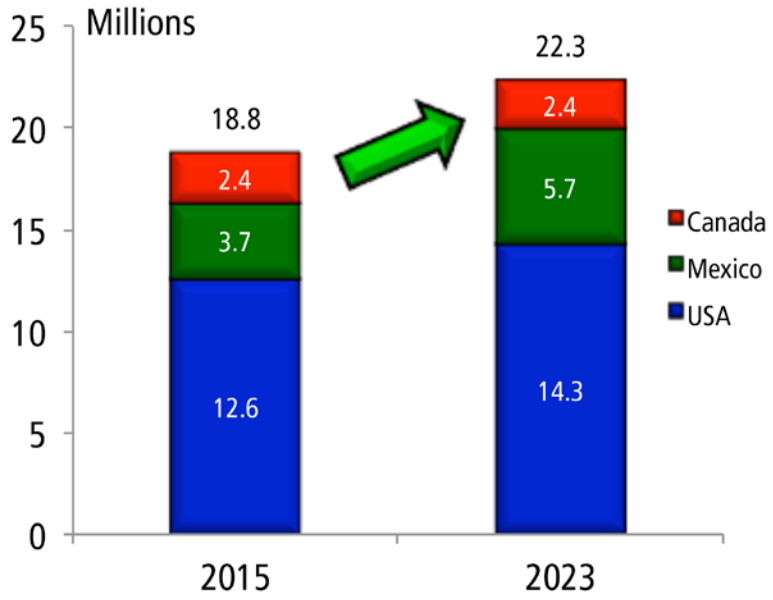
NORTH AMERICA PRODUCTION – MODEL LAUNCHES



	2015	2016	2017	2018	2019
Redesigns	13	11	18	26	16
New Entries	7	9	10	19	16
Total	20	20	28	45	32

Source: LMC Automotive

INVESTMENT POURS INTO NORTH AMERICA



2015 - 2023

	Δ *1000s*	Growth *% Δ*
Canada	-50	-2%
Mexico	2,000	54%
USA	1,628	13%
Total Capacity	**3,578**	**19%**

Investment in Mexico:

- BMW – San Luis Potosi
- Daimler – Aguascalientes (COMPAS) w/ Renault-Nissan
- FCA – Toluca
- Ford – Cuautitlan, San Luis Potosi
- Hyundai – Monterrey
- Mazda – Salamanca
- Renault-Nissan – Aguascalientes 2 & COMPAS
- Toyota – Guanajuato
- Volkswagen – San Jose Chiapa

Investment in the US:

- BMW – Spartanburg
- Daimler – North Charleston (DG) 2
- Faraday Future – FF USA
- FCA – Belvidere, Toledo North
- Fuji Heavy – Lafayette
- Geely – Ridgeville
- GM – Fort Wayne Truck, GM Van, Hamtramck, Lansing Grand River, Spring Hill
- Honda – Greensburg
- Hyundai – Montgomery
- Tesla – Fremont (Tesla)
- Toyota – Georgetown 3, Tupelo
- Volkswagen – Chattanooga

Source: LMC Automotive

GONE ARE THE DAYS WHERE MANUFACTURERS COULD COMPLETELY CONTROL THEIR OWN DESTINY BASED ON SECURING WHAT EXISTS WITHIN YOUR FOUR WALLS.



HOW MANUFACTURING EXECUTIVES CAN SLEEP BETTER AT NIGHT: 5 PRACTICAL STEPS TO PROTECT YOUR COMPANY – AND YOU - FROM CYBERTHREATS



Many manufacturing executives know they should be doing more to protect their organizations from the growing threat of cyberattacks. However, a lack of practical easy-to-understand guidance has many manufacturing executives frozen in their tracks trying to figure out their next move.

Technology is invading every manufacturing organization regardless of whether or not it has been invited in. The list of technologies is impressive and growing: 3D Printing, Internet of Things, robotics, cloud, sensors, virtual reality, etc.

Connectivity to the outside world is growing. Gone are the days where manufacturers could completely control their own destiny based on securing what exists within your four walls.

You wouldn't open the physical doors to your shop floor for anyone to come in and take a look around. However, many manufacturers are doing just that by leaving their virtual doors wide open.

Wondering where to begin? Start with these five pragmatic steps that anyone can take.

1. **Identify your "Crown Jewels"**. Many companies have never gone through the exercise of clearly defining the assets you are most concerned about protecting – i.e., intellectual property (IP), strategic plans, personally identifiable information (PII). Involve a team of leaders from across the company in this discussion and have the conversation in a group setting. Leaders will learn from one another as each has a different perspective (e.g., Human Resources vs. Operations). Once these "Crown Jewels" are identified, document them, label them and make sure everyone at all levels of the company knows to protect them.

2. **Recognize the enemy.** A key step in protecting your "Crown Jewels" is to understand who would benefit from stealing them from you. Who would want your employee data? Something as simple as a copy of a W-2 could provide enough information to steal someone's identity or file a bogus tax return on their behalf. Who would want your intellectual property? How could competitors benefit from access to your engineering schematics, new product R&D efforts and pricing strategies? Who would want access to your CEO's email? The answers to these questions will help establish a profile of the types of threats you need to protect against.

3. **Establish ground rules for handling sensitive data.** Sometimes the simplest solution is the best. Protect yourself from the most common scams by modifying processes to create a second set of eyes on key transactions. For example, ensure the treasury department cannot perform wire transfers without obtaining multiple approvals. Maybe include someone from outside of treasury in the review process to get another perspective? Or require a two hour hold before initiating the transfer?

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And the HR team must clearly understand the value of the data they possess. To protect employee personally identifiable information (PII), require that all external emails are encrypted? Require all documents to be password protected? Require that no data can be stored on external storage devices? Implementing simple ground rules may take time but may benefit you in the long run.

4. **Train Your Employees.** Your employees are your first and best line of defense. Some companies magically expect their employees to know about cyberthreats and what to do about them. It is true that new breaches are announced seemingly on a daily if not hourly basis, however, many employees don't understand anything more about the breach than something bad happened. It is critical for employees to understand the details of what happened and how it happened. Don't think it can happen to you? Type your company's name plus "HR generalist" into LinkedIn and you will get a list of people with the keys to some of the company's most sensitive information (i.e., salaries, social security numbers, performance reviews). These employees are likely targets for spearphishing where an attacker will specifically target them and trick them into divulging sensitive information or clicking on a malicious link. Educate employees on possible threats.

5. **Do Something!** Your employees need to know that this is an important issue and requires their attention. It's easy to include cybersecurity as a bullet on an agenda and think that conveys the

significance of the topic. It doesn't. Find something you can do to protect yourself which will serve as an example to others. For example, start using a Password Manager like LastPass or KeePass. Most people are trying to manage an overwhelming number of passwords so they cope by writing them down, tracking them in an unprotected Excel spreadsheet, or reusing the same passwords over and over again. A password manager solves this problem. Another idea would be to enable multi-factor authentication on the websites you personally use. The most common application is two-factor authentication where you receive a numerical code via text message on your phone (something you have – the first factor) when you enter your password into a site (something you know – the second factor). Visit www.twofactorauth.org to see websites and services that have enabled two-factor authentication.

Executing on these five simple steps will start you and your company down a path of improved protection from cyberrisks. Sweet dreams!

David Hartley, Principal
St. Louis, MO

> "Technology is invading every manufacturing organization regardless of whether or not it has been invited in."

CURRENT STATE OF THE MANUFACTURING INDUSTRY

According to a new Standard & Poor's report there are two key indicators that will tell you what kind of shape the manufacturing industry is in. The first is the Institute for Supply Management's manufacturing purchasing manager's index and the second is the Federal Reserve's Capacity Utilization Index for motor vehicles and parts. A reading above 50 percent for the ISM index indicates that manufacturing is expanding in the US, and below 50 means that it is contracting. History shows that each time since 1983 that the index fell below 43 percent "speculative grade" automotive companies began to panic. Similarly any time the Fed's utilization rate dropped below 72 percent during that period, it caused stress to automotive companies. Let's take a look at where we stand as of June 2016.

ISM Purchasing Managers Index: 53.2%

Fed.Capacity Utilization Rate: 75.1%



MANUFACTURING INDUSTRY INSIGHT

UHY LLP recognizes that manufacturing companies require their auditors, tax specialists and business advisors to add value to financial reporting activities. That is why we combine the strength of business and financial expertise with a hands-on, "shop floor" approach to solving complex business decisions in these key segments:

- Aerospace & Defense
- Distribution
- Automotive Suppliers
- Industrial Manufacturing
- Consumer Products

Our professionals are leaders in the industry and take the steps necessary to ensure our client's future success by identifying and addressing new trends, accounting requirements and regulations.

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