WELCOME

Bill Tofflemire, Membership and Education Director
National Association of Trailer Manufacturers
Today’s presenters

Joe Cataldo
Partner, Assurance Services, RSM US LLP

Chris Bradford
Partner, Tax Services, RSM US LLP
Agenda

• State of the industry
  - Information from:
    • RSM US Chief Economist – Joe Brusuelas
    • RSM Survey of Trailer Manufacturers (42 respondents)
    • Recreational Vehicle and Leisure Equipment Group
      • Client and prospect discussion
    • RSM US Middle Market Index – Q3 2017
    • RSM Manufacturing Monitor Survey - 2017

• Tax reform update and planning concepts
STATE OF THE INDUSTRY

Presented by: Joe Cataldo
2017 saw continued economic improvement
  - Marginal increases in revenue
    • Units sold and per unit bases
  - Margin compression due to materials and labor increases
  - The run continues… BUT, challenges persist!
    • Materials and commodity pricing concerns?
    • Materials and commodity availability?
    • Lack of skilled unskilled employees?
    • Rising labor costs?
    • Inflation?
Condition of business

- 2016: Thriving/Growing 50%, Holding Its Own 40%
- 2017: Thriving/Growing 60%, Holding Its Own 40%
- 2018: Thriving/Growing 70%, Holding Its Own 30%

Categories:
- Thriving/Growing
- Holding Its Own
- Declining
Growth prospects for 2018

- Very Optimistic
- Somewhat Optimistic
- Somewhat Pessimistic
- Very Pessimistic

For Your Company, the Trailer Industry, and the General Economy.
Growth prospects for 2018

• Middle Market Index – 125.7
  – Decline in Q3, but still well above 100.0
  – 61% of respondents expect profits to increase in the next 6 months

• Recreational vehicle and leisure equipment companies
  – Reporting increased revenue and earnings in current cycle
  – Expectation for increases in upcoming cycle as well
Big picture

• Election cycle
  - Republicans control legislative, executive and judicial branches of federal government
  - Unprecedented republican control at state/local level
    • 31 Republican governors (near high water mark)
    • Republicans control 67 out of 98 state chambers (record in modern era)
    • 24 states fully controlled by Republicans vs 6 states fully controlled by Democrats

• Society is very polarized
• Tax reform legislation passed
Big picture

• In 2018
  - Significant tax reform passed
  - GDP - 2.5 to 3.0% annualized growth in 2018
  - Increases in consumer spending
    • Higher disposable incomes through wage increases
    • Increases in spending on travel and luxury sectors
    • Changing demographics will certainly impact here
      • Boomers – Retiring and spending money on vacations and lifestyle components
      • Millennials – Highly mobile, renters. Focusing on experiences, not possessions
Big picture

• In 2018…
  - Equity market correction of 5 to 10%
  - Inflationary concerns return to economic landscape
  - Higher revenues, but continued margin compression
  - Labor
    • Unemployment rate drops to 3.5% nationally
    • Wages increases
    • Job growth slows
  - Look for increased consolidation and private equity activity
    • Monitor Survey reports approximately 50% of companies look to engage in M & A activity
Big picture

• Current cycle should continue into 2019/2020
  – Keep an eye on discretionary spend industries and inventory levels for signs of weakness

• Current cycle could extend into 2021 with tax reform
Big picture

- **Global economy**
  - Minimal foreign sales in trailer Industry
  - 2017 was challenging for existing foreign markets and even tougher in emerging foreign markets
  - Canadian economy stagnated
  - Chinese economy slowed
    - Debt concerns still exist
    - Deleveraging will continue to create volatility
  - European Union stabilized, but was relatively flat
    - Brexit!!! Others to follow…
    - Impact of immigration
  - South America in serious trouble
Big picture

• Oil and Gas
  - Continued recovery in 2017 (still volatile)
  - Current Prices ~ $60 a barrel
  - Expect oil to remain between $60 to $70 a barrel for 2018
• But…
  • How will OPEC react to continued depressed prices?
  • Continued economic crisis in Venezuela and Russia
  • Fracking an option, but not a boom
  • US production, government regulation and alternative fuels
Revenue - Current trends

• Revenue growth continued throughout 2017
  - 83% of NATM respondents reported revenue growth
  - 74% of Monitor participants reported revenue growth
  - On average, 5 to 15% growth (asymmetrical)

• Lower end, less complex product continues to be in highest demand
  - Disposable income is resulting in growth in higher end product lines though

• 70% of respondents increased sales prices in 2017
  - 80% of respondents raised prices 1 – 5%
  - 20% of respondents raised prices 6 – 15%
Revenue – Current trends

• Dealers/customers still control buying cycle
  - Brand loyalty continues to lag behind other industries
  - End consumers buy predominantly on price
  - Trailers are considered a commodity
  - Current cycle has trained dealers and manufacturers
    • Discounting and dealer centric programs
    • Dealers wait for shows, end of month or year for large orders and deals
Revenue – Current trends

• Dealer loyalty considerations
  - 74% of NATM respondents indicated that **product quality** is important to dealer loyalty
  - 50% of NATM respondents indicated that **brand name** is important to dealer loyalty
  - 47% of NATM respondents indicated that **product price** is important to dealer loyalty
Revenue growth for 2018

• 2018 Outlook
  - RV – 2.5% growth in 2018 (*Fall 2017 Roadsigns*)
  - Trailers per NATM respondents
    • 3% – No growth or declining sales
    • 11% - 1 to 5% growth
    • 44% – 6 to 10% growth
    • 30% - 11 to 20% growth
    • 12% – 21 plus% growth
  - RSM expectation – 10% growth
Revenue growth for 2018
Revenue growth for 2018

• How to get there?
  - 33% of Monitor respondents plan to grow through acquisition
  - 72% of NATM respondents are greatly or somewhat relying on increased product offerings
    • 69% of Monitor respondents are as well.
  - 100% of NATM respondents are greatly or somewhat relying on increased sales to current customers
  - 100% of NATM respondents are greatly or somewhat relying on acquisition of new customers (98 percent in 2017)
Revenue growth for 2018

- Other revenue observations
  - Increased opportunity for dealer floor plan arrangements
    - Percentage used by trailer manufacturers lags behind other industries
    - Dealer floor plan arrangements
      - Only 38% of NATM respondents have dealers that floorplan purchases at 61% to 100% of volume
  - Dealer programs
    - 38% of NATM respondents offer Interest Reimbursement (24% in 2017)
    - 41% of NATM respondents offer Volume Rebates
    - 71% of NATM respondents offer Discounts
## Cost structure considerations

<table>
<thead>
<tr>
<th></th>
<th>Decrease By More Than 10%</th>
<th>Decrease 1 to 10%</th>
<th>No Change</th>
<th>Increase 1 to 10%</th>
<th>Increase By More Than 10%</th>
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<td>Energy Costs</td>
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<td>43%</td>
<td>57%</td>
<td>0%</td>
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<td>Raw Materials</td>
<td>0%</td>
<td>0%</td>
<td>7%</td>
<td>86%</td>
<td>7%</td>
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<tr>
<td>Outbound Freight</td>
<td>0%</td>
<td>0%</td>
<td>23%</td>
<td>77%</td>
<td>0%</td>
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<td>Cost of Debt</td>
<td>0%</td>
<td>0%</td>
<td>57%</td>
<td>39%</td>
<td>4%</td>
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<tr>
<td>Wages</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>89%</td>
<td>11%</td>
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<tr>
<td>Income Taxes</td>
<td>10%</td>
<td>23%</td>
<td>37%</td>
<td>30%</td>
<td>0%</td>
</tr>
</tbody>
</table>
Raw materials

- **Inventory prices increase in 2017**
  - 1\textsuperscript{st} increase in 6 years
  - NATM respondents
    - 41% experienced increases of 1 to 3%
    - 32% experienced increases of 4 to 6%
    - 18% experienced increases of 7% or more
  - 74% of Monitor respondents experienced increase in raw materials prices
  - Inflationary pressures are coming
Raw materials – Aluminum and steel

• Commodity prices found a floor in 2017
• Global plants taken off-line or production limited
  - China expects to reduce output by 20% through 2020
• Impact of natural disasters
  - Demand to increase in order to rebuild parts of Texas, Florida and Caribbean
  - Automobile demand high after natural disasters
• Expect bottlenecks and shortages (especially in housing and automobile sectors)
• Spikes in commodity prices of 15 to 20% or more over 2016 lows are expected in 2018
Raw materials

- Growing inventory levels
  - 83% of NATM respondents expect to increase inventory levels in 2018
- Continued consolidation in supplier base
- Labor and materials constraints at supplier level will lead to shortages at OEM level
- Find alternative sources for key raw materials
• Foreign sourcing continues to lag behind other industries
  – 50% of NATM respondents are using foreign sourced raw materials (45% in 2017)
  – 44% of NATM respondents plan to decrease foreign sourced materials
Employee

• Employee productivity remains at a high level
  - How long can the trend continue?

• Labor market is very tight
  - 4.1% unemployment at October 2017
  - Asymmetrical – State ranges from 2.2 to 7.2%
    • Elkhart County – 2.6% at September 2017
    • Impacting OEMs and Suppliers alike

• Examples
  - Farmers Crops Rot Due to Worker Shortage (*Forbes – August 2017*)
  - Amazon Searches for Second Headquarters

• Say a prayer for your HR personnel
Employee

- Human capital shortages continue
  - 72% of Middle Market Index Respondents (skilled)
  - 75% of NATM respondents indicated that they were able to find skilled talent only some of the time or rarely (61% in 2017)
  - We are seeing difficulties in availability in all facets of the labor pool
  - 65% of NATM respondents indicated that workforce skills gap led to decreased productivity
    - Warranty and product quality impact
Employee

- Labor participation rate
  - Significant gap between new jobs created and number of new employees entering workforce
  - Rate comparison
    - Current participation rate is 62.7% (October 2017)
    - Pre-recession rate was 66.4% (January 2007)

- We are going the wrong way!
  - Isolationist policies will hurt in the near term

- Labor retention is a critical problem for employers
• Employee availability may get worse before it gets better
  - Midwest/West are net exporters of labor
  - Texas/Southeast are net importers of labor

• Relief is years away
  - Barring a significant change in political or economic environment
  - Impact of millennials

• Wage pressures
  - Most sectors of US economy are expanding workforces (Monitor)
  - Expected wage increases in 2018
    • Historical annual average is 1.5%
    • Unskilled - Forecasted to be at 3.5 to 4.0% or higher by region
    • Skilled - Forecasted to be at 5 to 8% or higher by region

• Unemployment rate is forecasted to be 3.5% by middle of 2018
Employee - Hiring levels in 2018

- Decrease by 1 to 9 Percent
- No Change
- Increase by 1 to 9 Percent
- Increase More Than 9 Percent

Employee

• Generally, manufacturers need a paradigm shift
  - Manufacturing is not glamorous, high tech
    • Focus on worker preferences
    • Focus on training

• Methods of attracting new employees
  - 65% of Monitor and NATM respondents are increasing compensation (base or incentive)
  - 31% of NATM respondents are focusing on quality of life matters
  - 31% of respondents have a shortage, but are not attracting new employees. Rather, they are using overtime to compensate for lack of quality employees
Other matters

• Cost of debt
  - Expect interest rates to climb
    • 2018 - 50 to 100 basis points over current levels
    • 2019 – 150 to 250 basis point over current levels
    • Could be impacted by inflationary spikes and growth in Europe

• Social media is primarily used for marketing (79%) and attracting new employees (44%)

• 0% of respondents reported a data breach in the past 12 months (same in 2016)
  - Only 28% of Monitor respondents have ERM that addresses vendor data security, systems penetration testing or post breach plans
Other matters

• Private Equity Group (PEG) Transactions
  - PEG feedback
    • Significant capital not deployed
    • Lack of overall quality deals
    • Large appetite for Company’s with $2.5 M of EBITDA or greater
  
  - RSM observations
    • Current economy still ripe for consolidation and acquisitions
    • Volume of transactions continues to increase in 2018
    • Size of transactions is stagnated
    • Potential carried interest tax law change not expected to impact deal flow
Forecast risks

• Federal Reserve overreacts to inflation with unnecessary spikes in interest rates
• Isolationism – Pull back from NAFTA and Other Treaties
  - $2.2 Trillion and 11.7 million jobs at risk
• Deterioration in European Economies
• Destabilization in Middle East
• North Korea
• 2018 Election Cycle in Italy (World’s 3rd largest bond market)
• Governmental investigations
TAX REFORM UPDATE
AND PLANNING
CONCEPTS

Presented by: Chris Bradford
The actual legislation – from 100,000 feet!

- Cuts $1.5 trillion of taxes over the next 10 years!

<table>
<thead>
<tr>
<th>Provision</th>
<th>House</th>
<th>Senate</th>
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</thead>
<tbody>
<tr>
<td>Corporate rate cuts and alternative minimum tax</td>
<td>($1.5 trillion)</td>
<td>($1.3 trillion)</td>
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<tr>
<td>Pass-through cuts</td>
<td>($600 billion)</td>
<td>($362 billion)</td>
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<tr>
<td>Limit ‘active’ losses</td>
<td>$0 billion</td>
<td>$137 billion</td>
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<tr>
<td>Limit net interest</td>
<td>$172 billion</td>
<td>$308 billion</td>
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<tr>
<td>Limit net operating losses</td>
<td>$156 billion</td>
<td>$158 billion</td>
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<tr>
<td>Domestic production</td>
<td>$95 billion</td>
<td>$80 billion</td>
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<tr>
<td>R&amp;E amortization</td>
<td>$109 billion</td>
<td>$62 billion</td>
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<tr>
<td>International</td>
<td>$279 billion</td>
<td>$154 billion</td>
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</table>
Who ‘should’ get a cut? Who is paying the bulk of the income taxes now?

• According to the Joint Committee on Taxation (JCT) --
  – ‘Individuals’ get 56 percent of the tax cuts
  – ‘Business’ (i.e., corporations) get 44 percent of the tax cuts

• If the tax cuts were roughly proportional to the distribution of current individual and corporate income taxes paid –
  – Individuals would get 86 percent of the tax cuts
  – Corporations would get only 14 percent of the tax cuts
  – Even more skewed towards individuals if you included payroll taxes
The vast bulk of federal revenues come from individuals, there is no other ready source.

Revenues in 2016

- **Individual Income Taxes**
  - $1,546 Billion

- **Payroll (Social Insurance) Taxes**
  - $1,115 Billion
  - Old-Age, Survivors, and Disability Insurance: $810 Billion
  - Hospital Insurance: $247 Billion
  - Other: $58 Billion

- **Corporate Income Taxes**
  - $300 Billion

- **Other**
  - $306 Billion
  - Federal Reserve Remittances: $116 Billion
  - Excise Taxes: $95 Billion
  - Miscellaneous Fees and Fines: $39 Billion
  - Customs Duties: $35 Billion
  - Estate and Gift Taxes: $21 Billion

Billions of Dollars
And . . . U.S. personal income is predominantly wages and salaries of middle-income taxpayers – not high-income investment or business income.

How Much Income is Earned by Different Income Groups (by AGI) – 2015?

Source: 2015 IRS Statistics of income

Approximate Lower Border of The Top 1 Percent* (AGI over $500,000)
Back to the TCJA: Individuals vs. corporations vs. pass-throughs

• Both bills are ‘business heavy’ – more than appears
  – If you recast the pass-through provisions as ‘business’ not ‘individual,’ the share of tax cuts going to corporate and individual businesses would be close to 80 percent in the House bill and 70 percent in the Senate bill
  – In contrast, the corporate and business share of total income and income taxes is probably closer to 20 percent to 30 percent

• Senate still favors C corporations over pass-through entities more than House – even after last-minute amendments
‘Headline’ House business tax provisions

• Corporate rate reduced from 35 percent to 20 percent (25 percent for personal service corporations)

• Top ‘pass-through’ rate of 25 percent for ‘qualified business income’ of individuals – with complex limits for ‘active’ owners (70/30 rule)

• Three-year holding period for ‘carried interest’ capital gains, but no other changes

• Repatriation of off-shore profits of U.S. corporate subsidiaries at a reduced rate – with future offshore business profits exempted from U.S. tax
Other favorable House business tax provisions

- Expanded use of cash method of accounting for small C corporations and partnerships with C corporation partners ($25mm revenue cap)
- Repeal of the corporate AMT
- Faster depreciation of capital investments
  - 100 percent bonus depreciation through 2022
    - Expanded definition
  - $5 million section 179 deduction allowance
Other major House business tax provisions

• End the domestic manufacturing deduction
• End the exclusion from income of certain contributions to capital (e.g., state/city grants)
• Limit allowable deductions for net interest expenses to 30 percent of earnings before interest, taxes, depreciation and amortization (EBITDA), with exceptions, including for real estate and small business
• Mostly end net operating loss (NOL) carrybacks except in limited circumstances; limits on NOL carryforwards
• Limit like-kind exchanges to real property
• Eliminate the Work Opportunity Tax Credit
• Retain Research and Development credit
SENATE BUSINESS TAX PROPOSALS
Major Senate changes to House business provisions

• 23 percent pass-through deduction instead of lower tax rate

• Still materially higher taxes on pass-throughs than House, even after amendments
  – but allows certain active partners and personal service businesses to benefit more than under House bill
  – fundamentally different eligibility rules for pass-through tax benefits
  – Capped at 50% of W-2 wages paid

• Surprising new limitations on using ‘active’ losses of pass-throughs against salaries and investment income
Other Senate changes to House business provisions

• Unlimited carryforward of unused interest deductions
• Modest differences in cost recovery rules
• Phase-out of expensing, not immediate expiration
• Retains the corporate AMT (and a modified individual AMT)
Comparison of effective tax rates between plans

Comparison of Maximum Marginal Rates for Entity that Qualifies for DMD

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<tr>
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<th>Current</th>
<th>DMD Applicable</th>
<th>DMD Not Applicable</th>
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<tr>
<td>Top Individual Rate</td>
<td>39.60%</td>
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<tr>
<td>Domestic Manufacturing E</td>
<td>0.09</td>
<td>-3.56%</td>
<td>0.00%</td>
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<tr>
<td>Maximum Marginal Rate</td>
<td>36.04%</td>
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<td>39.60%</td>
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House

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<tr>
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<th>Active Owner</th>
<th>Passive Owner</th>
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<tbody>
<tr>
<td>70% @ 39.6%</td>
<td>27.72%</td>
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<tr>
<td>30% @ 25%</td>
<td>7.50%</td>
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<tr>
<td>Maximum Marginal Rate No DMD</td>
<td></td>
<td>35.22%</td>
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<tr>
<td>100% @ 25%</td>
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<td>25.00%</td>
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Senate

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<th></th>
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<tbody>
<tr>
<td>Top Rate</td>
<td>38.50%</td>
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<tr>
<td>Deduction @23%</td>
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<td>-8.86%</td>
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<tr>
<td>Maximum Marginal Rate No DMD</td>
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<td>29.65%</td>
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HOUSE INDIVIDUAL TAX PROPOSALS
Selected House individual tax provisions

• Condense the number of tax brackets from seven to four, including 12 percent, 25 percent, 35 percent and 39.6 percent brackets
• Repeal deduction for personal exemptions
• Increase the standard deduction to $12,000 for individuals and $24,000 for married couples ($12,200 and $24,400 in 2018)
• Repeal the overall ‘Pease’ limitation on deductions
• Eliminate itemized deductions for:
  – State and local income taxes, but allow deduction for up to $10,000 for state and local property taxes
  – Casualty and theft losses, medical expenses and alimony
• Preserve deduction for charitable contributions
  – Increase the adjusted gross income (AGI) limitation for cash contributions to public charities and certain private foundations from 50 percent to 60 percent
Selected House individual tax provisions (cont.)

• Limit the home mortgage interest deduction for newly purchased principal residences to interest on $500,000 of indebtedness, while grandfathering mortgages existing as of Nov. 2, 2017
  – No deduction for home equity loans or second homes
  – Extend required period of ownership and use as residence and phase-out exclusion of gain on sale of principal residence for taxpayers with AGI over $500,000 married filing joint ($250,000 single)

• Repeal the AMT

• Retain pre-tax contribution limits for 401(k) plans

• Extend carried interest holding period from one to three years

• Double the current estate, gift and generation-skipping transfer (GST) tax exemptions to approximately $11 million, effective January 2018, with complete repeal of the estate (and GST) tax in 2025
  – Retains the gift tax and the step-up in basis for inherited property

• Parents may set up 529 plans for unborn children. Additionally, up to $10,000 per year of plan funds could be used for private elementary and secondary school expenses
Key items retained (or undisturbed) in House bill

• Income tax
  – The 3.8 percent tax on investment income under section 1411 and the .9 percent Medicare tax on compensation
  – Tax rates on capital gains and dividends
  – Ability for beneficiary to stretch individual retirement account (IRA) withdrawals

• Estate and gift tax
  – Current design flexibility of grantor retained annuity trusts (GRATs), no minimum 10-year term
  – Treatment of grantor trusts
SENATE INDIVIDUAL TAX PROPOSALS
Senate Republicans – selected individual provisions

• Keeps seven individual income tax brackets
  – 10 percent, 12 percent, 22.5 percent, 25 percent, 32.5 percent and 38.5 percent
  – Top rate of 38.5 percent applies at incomes of $500,000/$1 million
  – Simplifies the ‘kiddie tax’

• Doubles the standard deduction to $12,000 for individuals and $24,000 for married couples

• Eliminates federal deductions for state and local taxes
  – Retains deduction for up to $10,000 for state and local property taxes

• Retains AMT, but increases exemptions

• Repeals the individual mandate of the Affordable Care Act

• Preserves medical expense deduction, albeit temporally

• Retains current mortgage interest deduction, but not for home equity loans

• Preserves exclusion of gain on sale of residence but extends required period of ownership and use as residence

• Most individual provisions are set to phase out after Dec. 31, 2025
Senate Republicans – selected individual provisions (cont.)

- Retains pre-tax contribution limit for 401(k) plans
- Retains charitable contributions and increases AGI limit for cash contributions to 60 percent
- Repeals all miscellaneous deductions (that are subject to the 2 percent rule)
- Doubles the exemption for the estate, gift and GST tax
  - Does not eliminate estate and GST tax
  - Retains current 40 percent rate and stepped-up basis
  - Gift tax remains in place
- 529 savings plans could be used for public, private and religious elementary and secondary schools, as well as home school students.
PLANNING: WHAT DO I DO NOW?
Planning strategies?

• Bills are quite similar, and more likely than not to pass

• Many traditional deferral strategies continue to be useful in an environment of declining rates, and disappearing deductions

• Major changes in business structures may be worth considering in 2018
Key planning considerations

- Cost Segregation studies for any past real estate acquisitions
- Review accounting methods to accelerate deductions or defer income into 2018
- Maximize deductions eliminated post-2017
  - State income taxes
  - Maximize prepaid expense write-offs
  - Real estate taxes (limited to $10k in 2018)
  - Other itemized deductions
  - Charitable contributions (consider DAF)
Business structuring

• C corporation v. flow-through tax rate
• Modeling is critical
• How much cash do you take out of business (not used to pay taxes on company profits)
• Timeline to exit the business
• C corporations will still have double layer of taxation
• Conversion from LLC cannot be unwound
• Consider distributing flow-through profits in 2017
QUESTIONS AND ANSWERS?
THANK YOU FOR YOUR TIME AND ATTENTION