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BUSINESS

# Big Manufacturers Tighten Supply Chains as Low-Growth Forecasts Spread

GE and UTC are squeezing or realigning suppliers to maintain profit margins

Industrial companies facing a prolonged period of slower growth are reexamining their supply chains and parts costs as they look for ways to maintain profit margins. Shown, a worker at a General Electric plant in France works on a gas turbine.
*PHOTO: AFP/GETTY IMAGES*

By **TED MANN**
Dec. 23, 2015 6:09 p.m. ET

Since the 1970s, General Electric Co. has bought precision-drilled metal components from a small company in New Jersey, a classic example of an industrial company outsourcing its parts-making.

Not anymore.

GE earlier this month agreed to pay an undisclosed amount to acquire Metem Corp., the

Parsippany, N.J.-based supplier, according to an internal memo. The purchase is one way the conglomerate hopes to cut $1 billion in annual costs from its supply chain, including making more of its own parts or buying the companies that make them.

Large industrial companies like GE are squeezing suppliers for lower costs and shifting existing factories to cheaper locales as they seek to maintain profit margins in what could be a prolonged period of slow global growth.

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In November, the Organization for Economic Cooperation and Development projected global gross domestic product next year will rise 3.3%, slightly up from 2.9% in 2015, but reflecting a slowdown in what had been stronger growth in China.

Executives from United Technologies Corp., maker of Pratt & Whitney jet engines, Otis elevators and Carrier air conditioners, told investors this month they planned a $1.5 billion restructuring effort through 2018.

UTC Chief Executive Gregory Hayes said more than half of the company's 42 million square feet of manufacturing space, especially in Europe, was in his cross hairs as he looks for ways to cut costs and boost profit margins after a tough 2015.

Mr. Hayes, like GE CEO Jeff Immelt, spent much of a recent annual investors meeting assuring them he would be driving a hard bargain with suppliers—especially those who provide the roughly 8,000 parts needed to assemble a jet engine.

"The weak link in our whole manufacturing process remains the supply chain," said Mr. Hayes, who said a corporate team was working to ensure suppliers delivered parts on time. "As good as our factories can be, if you have a crappy supplier, it doesn't matter. You need all the parts."

Both companies also want to source more parts in lower-cost countries. Last week, Mr.

Immelt said GE would raise the percentage of components that come from China, India, Mexico and Russia to 30% of its total, up from about 20% today. It is another part of GE's $1 billion savings goal and a bet that the company can pay suppliers less thanks to the price drop in commodities, excess capacity at producers in China, and a strong U.S. dollar.

"GE's going after rooftops," said Deane Dray, an analyst at RBC Capital Markets who has long covered the sector. "They want to close facilities and take out cost."

*'He has got to execute on delivering the backlog at a better margin.'*

—Scott David, Barclays analyst

GE and its peers are projecting slow economic growth in the coming year. The Fairfield, Conn.-based conglomerate last week projected its sales, excluding acquisitions or divestitures, would rise between 2% and 4% next year, while United Technologies says its sales should rise between 1% and 3%. A cooling economy in China won't generate the growth in sales of new elevators and escalators it did in the past. Prolonged low crude-oil prices are triggering cost-cuts in GE's oil and gas business, including the closure of a decades old foundry in Lufkin, Texas.

Mr. Immelt has "the backlog," said Scott Davis, an analyst with Barclays. "Now he has got to execute on delivering the backlog at a better margin."

Enter Metem, a firm with around 250 employees working in a niche business: the company drills tiny, precise holes in metal components that fit inside GE's massive power turbines, providing a cooling flow of air that lets the turbines run hotter without damaging their parts.

GE says it is Metem's largest customer and that it would be more efficient to simply buy the supplier. It is part of the strategy Mr. Immelt chose to emphasize in mid-December, when he said GE currently buys $30 billion of supplies each year from third parties that GE itself designed. Comparing what those goods should cost and what GE is paying, he said, "allowed us to look at some components that we might think about bringing in-house."

GE hasn't publicly disclosed its purchase of Metem, and declined to disclose the purchase price for the business. Metem didn't immediately respond to a request for comment.

Up the road from GE at United Technologies' headquarters in Farmington, Conn., the first order of business isn't finding a supplier to absorb, but finding a factory to restructure or close altogether.

The company has "some of the most productive factories in the world and yet all of our suppliers or all of our competition has moved to low-cost" areas, Mr. Hayes said. "And so, we're going to have to follow them."

**Write to** Ted Mann at ted.mann@wsj.com