Written Testimony
of
Michael K. Baach, President & CEO
Philpott Solutions Group, Inc.
before the
Ways and Means Subcommittee on Tax Policy
hearing on
"Tax Reform and Small Businesses; Growing our Economy and Creating Jobs"

Good morning Mr. Chairman, Ranking Member and Members of the Committee. I am very pleased and proud to address you this morning regarding the impact of Tax Reform on Small Businesses.

My name is Mike Baach and I am President of the *Philpott Solutions Group, Inc.*, headquartered in Northeast Ohio. Although Philpott is still considered small, our story and contributions to our customers, employees and suppliers' success are broad and vibrant. To fully appreciate the positive impact Tax Reform is having on our business, it is helpful to understand a bit of Philpott's history.

In 1889, John W. Philpott started *The Philpott Rubber Company* in Cleveland, Ohio. Philpott sold fabricated custom rubber parts and other items to local industrial companies, much of which remain our core competency. Mr. Philpott established a culture of being creative and customer-minded while always displaying a positive, energetic attitude. His vision guided our company through two World Wars, the Great Depression and all too many recessions. Because we have maintained John W. Philpott's values, we are confident that our company will remain strong and sustainable long into the future.

I am only the sixth president of Philpott, the position from which I will be retiring at our June 7th annual shareholders meeting I was given the privilege of serving Philpott's highly dedicated employee owners in September 2009. Since then, we have more than tripled in size by diversifying to become participants in the supply chain in many growth sectors of the USA market. This has included serving the industrial, residential and commercial construction, durable goods and oil and gas sectors, nearly all of which are owned or operated in the United States.

I mentioned employee/owners, who now total about 40. Philpott is owned almost exclusively by our employees. This came about when in 1977 there were no Philpott family heirs who wanted to run the company. The Philpott family sold Philpott to its employees through a then new provision in the tax code called an Employee Stock Ownership Plan, more commonly referred to as an ESOP[1]. Each year, the company is permitted to contribute up to 25% of an employee's compensation to his or her ESOP account up to a maximum of just over $50,000, without tax liability to the employee. The amount of each annual contribution is at the discretion of the company's Board, which in our case strives to reward each employee the maximum allowable contribution. The cash in each employee's ESOP account is then used to purchase shares of fellow employees at retirement, the value of which is determined by an independent appraiser following a certified audit of our prior year's financial results. This assures that the ownership of Philpott remains with our employees. As owners of the company, Philpott employees have vested interests in being creative and customer-minded with the same positive, energetic attitude that our founder established.

[1] An ESOP is a defined contribution plan, a form of retirement plan as defined by 4975(e)(7)of the IRS tax code, which became a qualified retirement plan in 1974.

Our *Philpott Rubber & Plastics Company* continues our legacy business by selling custom manufactured polymeric parts for industrial applications. Over time, customers demanded lower pricing for these parts by threatening to buy what they viewed as commodity products from global sources, primarily China and India. We viewed their behavior of running to regions whose producers had lower tax and labor costs as short sighted. However, we were left with no choice but to move much of our production offshore when we were told by one of our largest customers, "you can either join us our move of our some of our product production to China, or we will find someone that will!" Our compliance with these customers' demands, unfortunately, also forced Philpott to close its rubber molding factory in 2003.

Because of the relatively small scale of Philpott's production needs, we established contract manufacturing partnerships with three (3) rubber molders in the Shanghai area. To make it easier for our China-based customers to buy from us, we were eventually required to establish the *Philpott [Beijing] Science & Technology Development Company, Ltd*., a Wholly Foreign-Owned Enterprise or WFOE[2] under China's foreign investment business registration laws.

Admittedly, our China-made products cost substantially less than those that we could make in the USA. This was due to the incredibly low labor costs and modest income taxes paid by our contract manufacturer on his profits in China. Over time, more and more problems emerged, primarily due to inconsistent product quality. Despite the expense for adding third-party inspection of parts before they were shipped from China and repeated trips by our executives for meetings with our China manufacturing contractors' management, prices of parts manufactured in China remained at least 25% less expensive than we could produce in the USA. However, even though our customers' allure of perceived lower cost of parts made globally, Philpott's management and financial resources were increasingly strained in managing global quality issues.

In 2014, more than decade after Philpott initiated its outsourcing program, our Board of Directors directed Philpott management to investigate reshoring molding operations to the USA. Our technical team eventually discovered a rubber compound whose chemistry resulted in manufacturing cycle times substantially reduced from those we had been using, including in China. This would allow us to partially close the gap in the labor component of parts we could make domestically. Our analysis also included the elimination of costs for transportation, custom, insurance and duties on products imported from China as well as the indirect cost of quality. On a one-off basis, landed costs for China produced parts still remained less.

In 2015, the China product quality became intolerable and placed Philpott at risk of losing significant business. Although the lower labor and tax rate advantages of manufacturing in China remained, the certain loss of customer loyalty was unacceptable. At that time, Philpott management also believed that the long debated federal tax reform would eventually happen. We were confident that such tax reform would stimulate growth of the companies that operate in the market sectors we served, thus creating additional business opportunities for us. All of this gave us the courage to invest more than $5,000,000 to buy and upgrade a 43,000 square foot building in Aurora, Ohio, which we then equipped with brand new rubber molding equipment.

---

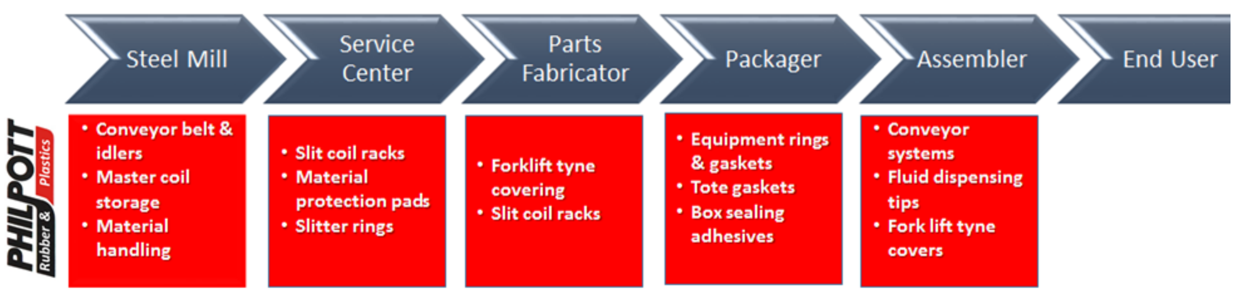
[2] A **WFOE** is an investment vehicle for a business in mainland China where foreign individuals or corporate entities can incorporate a foreign-owned limited liability company. WFOE's do not require involvement of a mainland Chinese investor, unlike most other investment vehicles in China companies.

While we continue to operate our company-owned warehouse and fulfillment center in Brunswick, Ohio, our new Aurora, Ohio manufacturing facility has recently been commissioned and is in the process of making samples for customers' testing of the parts we are bringing back from China. Already, this has created six (6) new jobs and plans are for another 15 to 20 new manufacturing positions to be created over the next 3 to 5 years as our process of reshoring continues.

Tax Reform has already made significant contributions to Philpott and our employees. First, each employee received a $1,500 bonus in their last pay in December 2017, which our Board awarded as a direct result of Tax Reform. This amount was in addition to the performance-based cash bonuses that are normally paid by March 15th of the year following our fiscal year ending December 31st. In early 2018, our employees noticed and expressed their appreciation for the increase in their take home pay that Tax Reform created. Combined with their ownership in Philpott, keeping more of their salary and cash bonuses has provided added motivation to better serve our customers, thus helping our business grow.

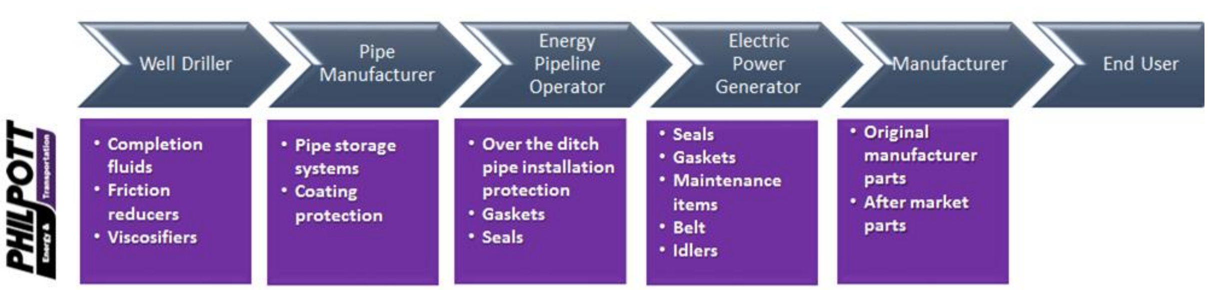
Even more importantly, we have enjoyed significant growth in sales as a result of our customers' business expansions. Philpott does not sell directly to end users. Rather, we sell parts and subassemblies to manufacturers who may also be a tier or more away from the end user. As a result, we are seeing favorable impact from Tax Reform on all levels of the supply chains in which we participate. This includes revenue growth leading to job creation. Take for example the durable goods sector, which often uses steel as a component part. Philpott has seen growth in our sales of products to multiple levels of the durable goods supply chain as shown in the simple diagram below:

Durable Goods Supply Chain



We also sell a food grade polymer to energy exploration and production companies that operate in the Utica and Marcellus Shale Basins. Through our subsidiary, *Philpott Energy & Transportation Company* sells a product that cleans a well after the hydraulic fracturing process, just before the well goes into service. This is the stage well drillers call the completion phase. During this process, Philpott field technicians deliver our patented product to the well driller using a proprietary, computer-controlled pumping unit. The completion phase usually requires Philpott product, equipment and personnel to be on the drill location 24-hours per day for three (3) to five (5) days. Therefore, often Philpott products are sold to customers in multiple tiers of the industrial energy for manufacturing operations supply chain as diagramed below.

Oil & Gas Supply Chain



As a small business, Tax Reform is creating growth drivers for Philpott in numerous ways. It gave us the courage to invest more than $5,000,000 in a new facility, equipment and upgraded manufacturing utilities infrastructure. This investment will, in turn, allow Philpott to reshore back to the USA manufacturing jobs that were sent to China a decade ago back. It will allow us to innovate new products to better serve our new and existing customers. All of this will drive growth in our business, new jobs and increased wages and cash bonuses for our employees. All of this will bolster our USA patriotism, which we call *Philpott Pride*!

Thank you Mr. Chairman, Ranking Member and Committee Members. I am happy to answer any questions the Committee may have and to assist the Committee in its work.