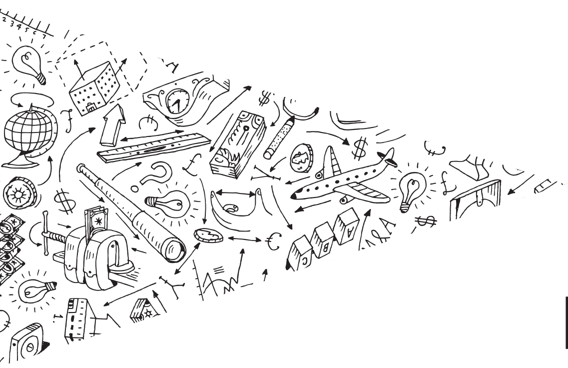
4th Issue
**Outlook April-October 2011**

# Capital Confidence Barometer



## Fit for the future?

### About this survey

Ernst & Young's *Capital Confidence Barometer* is a regular survey of senior executives from large companies around the world conducted by the Economist Intelligence Unit (EIU).

Our panel, the "Ernst & Young 1,000" is comprised of selected Ernst & Young clients and contacts and regular EIU contributors.

This snapshot of our findings gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their capital agenda.

### Profile of respondents

- Panel of more than 1,000 executives surveyed in February and March 2011
- Companies from 62 countries
- Respondents from over 40 industry sectors
- 559 CEO, CFO and other C-level respondents
- 248 companies would qualify for the Fortune 500 based on revenues

### The Capital Agenda

1. Preserving capital: reshaping the operational and capital base
2. Optimizing capital: driving cash and working capital and managing the portfolio of assets
3. Raising capital: assessing future capital requirements and assessing funding sources
4. Investing capital: strengthening investment appraisal and transaction execution

Our fourth Capital Confidence Barometer reports a surge in confidence in the global economic outlook. Confidence in the global economy has almost doubled in the last six months. Leading companies are now focusing on growth instead of defensive measures.

Capital market conditions remain strong and confidence in many local economies and industries also remains high. However, more recent external factors such as political instability in the Middle East and rising inflation and natural disasters are creating longer term uncertainty. This is leading to mixed messages for M&A.

In the short term M&A appetite is up, with one third of those surveyed looking for a new acquisition in the next six months. Longer term the appetite for M&A declines – albeit from a relatively robust level – as companies identify organic growth as their No.1 priority. The growing valuation gap between buyers and sellers could also constrain M&A appetite. We should see increased levels of M&A in 2011 – but further external shocks may prompt boards to rein in acquisition plans.

Our latest findings again underline one critical point: how companies manage their capital agenda today will define their competitive position tomorrow. How they raise, invest, optimize and preserve their capital is vital to their future success. The Barometer clearly shows that many leading companies are in a strong position to determine their strategic course, while others are struggling to respond to current market challenges.

Pip McCrostie – **Global Vice Chair,** Transaction Advisory Services.

## Survey highlights

Our findings point to:

- Global confidence surge – the financial crisis is over, or the end is in sight
- Capital market conditions are at a post-crisis high, and leading companies have refinanced
- Newfound confidence is resulting in boards focusing on growth
- Short-term, M&A activity is set to increase but remains well below pre-crisis levels
- The No.1 strategic priority for companies remains organic growth

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# Our perspectives

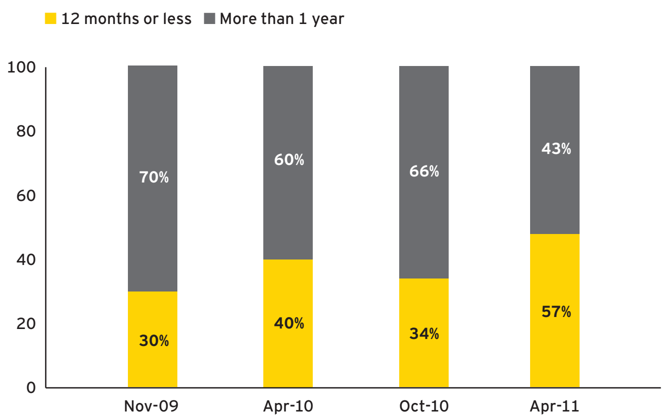
- Global confidence is returning. However, any sustained upturn is likely to be determined by external factors: rising inflation, continued political instability in the Middle East, austerity and tax regimes and the impact of natural disasters on supply chains
- Leading companies have completed refinancing, but for those who haven't the need is now urgent
- The survey shows that boardrooms are cautiously focusing on growth in light of the above factors
- There are mixed implications for M&A. At least in the short term, the outlook for M&A activity is getting brighter, and the increasing number of companies planning to acquire and divest in the next six months should increase deal activity. Targets are likely to be emerging market companies in the automotive, consumer products, mining and pharmaceutical sectors
- Longer term, if the external factors stabilize or diminish, we may see a resurgence in M&A
- In the current market the highest priority in the boardroom remains organic growth

# Economic outlook

## Boardrooms bullish on recovery.

Confidence in the global recovery has surged since October 2010. Buoyed by high equity values, stabilizing capital markets and low interest rates, we are now seeing the first significant increase in confidence from respondents in 18 months. Almost 60% of executives now think that the global economy will have recovered by April 2012. Nearly a fifth (17%) believe that the financial crisis is already over.

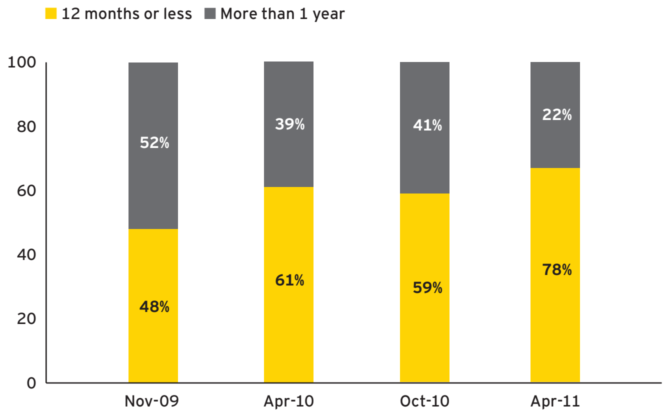
**How long does your organization expect the financial crisis to persist in the broader economy?**




**17%** For the first time, we asked, "Does your organization believe the global financial crisis is over?" 17% said "Yes."

Survey respondents are even more positive when viewing the outlook through an industry lens. A third (33%) say the financial crisis is over in their sector, and 78% expect the recovery to be well under way in the next 12 months.

**How long does your organization expect the financial crisis to persist in your industry?**




**48%** of technology and 45% of oil and gas sector participants believe the financial crisis is over in their sectors.

Participants also remain upbeat about their local markets. Two-thirds (66%) are optimistic about their local economy, up from 64% in October 2010. Levels of confidence in Germany and China remain high.

**64%** of companies in the US are now more optimistic, compared with 54% six months ago.

The survey reveals a surprising decrease in confidence in India and Russia. The UK (48%) and Spain (40%) show the lowest levels of confidence around the world.

# Capital markets

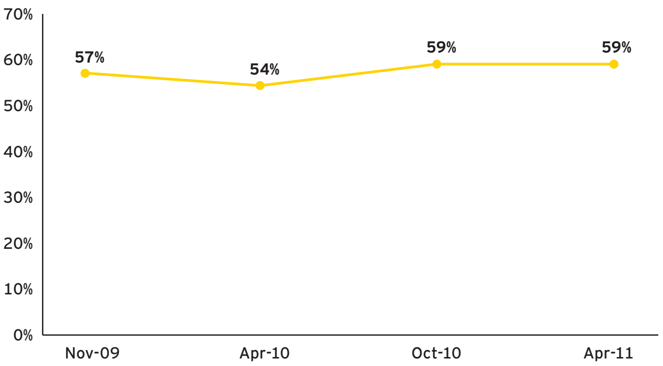
## Capital market conditions continue to strengthen.

Almost 60% of companies say capital market conditions are continuing to improve. Thirty-eight percent say access to funding for capital projects is not a problem. And balance sheet leverage remains low: only 13% of companies in the survey have a debt-to-capital ratio above 50%; the majority are below 25%.

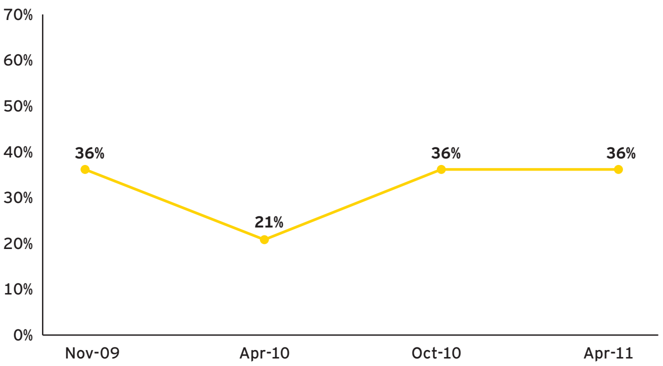
With banks re-establishing their capital positions and interest rates low, financing for deals is increasingly available. The preferred sources for funding over the next six months remain cash (59%) and bank loans (36%).

### What will be your main source of deal financing in the next 6–12 months?

**Cash**




**Bank loans**



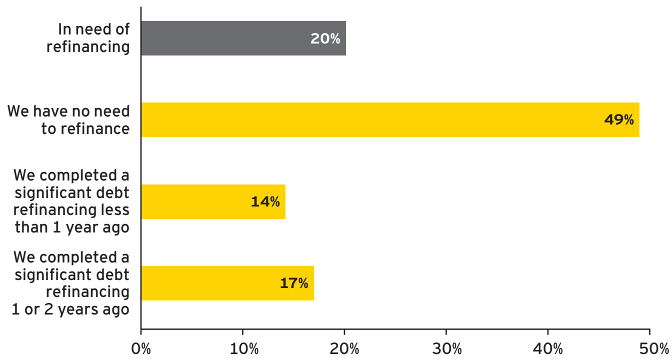

## The pressure to refinance is over for leading companies.

Over the past six months, the percentage of companies that have refinanced has significantly increased. Eighty percent of the businesses surveyed say they have completed refinancing, compared with 52% in October 2010. But for those that need to refinance, the speed with which they need funds is increasing rapidly. Nearly two-thirds (63%) need to refinance within six months, a three-fold increase since October 2010.

The results point to the availability of financing as a polarizing factor among boardrooms — dividing the corporate landscape into those who are thriving and well-placed to grow organically or through M&A and those who are struggling and lack the capital to compete.

**80%** of businesses in the survey have now completed or have no need to refinance.

### Which of the following most accurately describes your company's debt/refinancing situation?



# Mergers and acquisitions outlook

## Mixed messages for M&A.

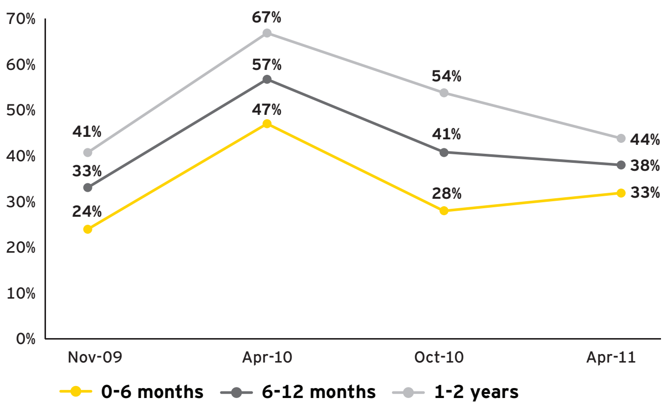
The surge in global confidence is encouraging businesses to focus on growth rather than defensive measures.

In the short term, appetite for acquisitions is increasing, but overall, companies are focused on organic growth. This caution is driven by three dominant external factors that have arisen in the past six months: political instability in the Middle East; natural disasters and their impact on supply chains; and tax and inflationary concerns.

A third of companies are likely to acquire in the next six months. Since October there has been an uptick (from 28% to 33%) in the percentage of companies likely to acquire in the next six months reflecting newfound confidence in economic recovery.

Longer-term, nearly half of all companies expect to be acquisitive. The proportion likely to acquire in the next one to two years continues to decline. However, if the external factors diminish, we could see this figure increase.

**How likely are you to execute acquisitions in the following periods?**

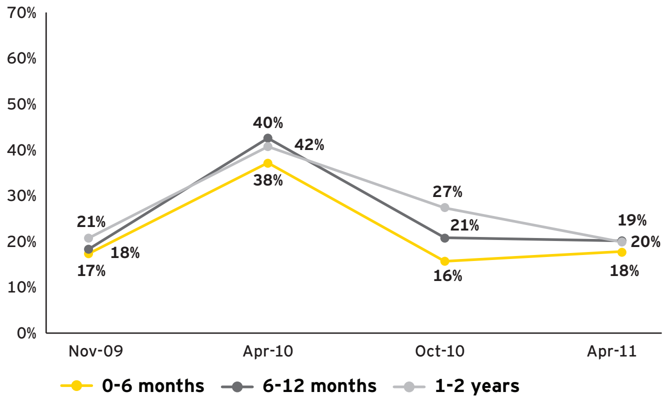



**36%** of US companies surveyed are likely to acquire in the next six months.

Acquisitive sectors in the next six months include power and utilities, oil and gas, and pharmaceuticals.

Divestment activity is also expected to rise in the short-term. A fifth (18%) are likely to dispose of assets. Mirroring the acquisition trend, the percentage likely to divest over the next one to two years falls (from 27% to 19%).

**How likely are you to execute divestments in the following time periods?**




## Barriers to M&A are increasing.

The No.1 deal breaker now relates to the valuation gap between buyer and seller expectations, which leapt by nearly a third (from 38% to 50%). In October 2010, the biggest obstacle to completing an M&A transaction was stakeholder caution: more than half of companies (52%) cited it as a problem. Stakeholder caution is still a serious obstacle, but it has eased a little (down to 46%).

Management challenges, meanwhile, have grown in significance. Concerns over the uncertainty or complexity of valuations are significant and growing (from 41% to 49%).

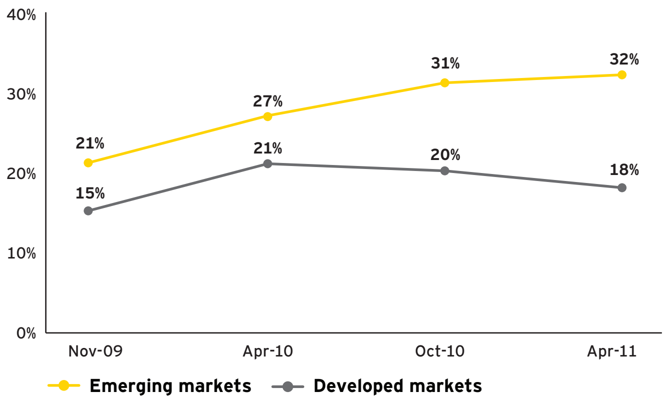
Management is additionally demanding a stronger business case before supporting a transaction: the percentage of companies saying that business case thresholds or hurdle rates are blocking deals increased by a third (from 30% to 39%).

## Emerging markets continue to drive growth.

Enthusiasm for globalization and emerging market investment remains strong as companies look for ways of fueling growth.

The percentage of companies saying they are considering an emerging market acquisition within six months is 50% higher than it was in November 2009 and continues to rise. By contrast, interest in developed market transactions is low and falling (to 18% from 21% this time last year).

**Likelihood of undertaking emerging and developed market acquisitions in the next six months.**




## Sectors most likely to acquire in the emerging markets are automotive, consumer products, mining and pharmaceuticals.

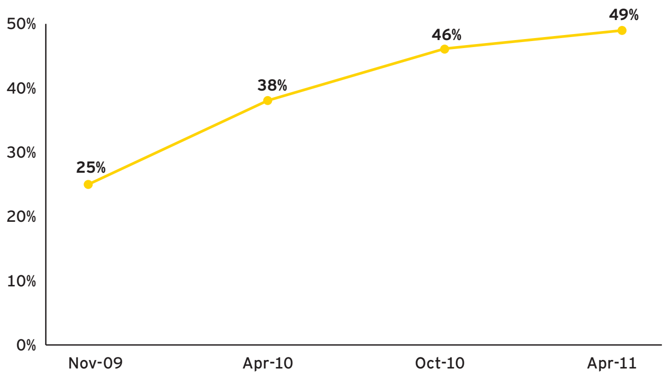
The most popular structure for an emerging market transaction is a joint venture/alliance (29%). This is not surprising given the significant risks associated with an emerging market investment, not least in the areas of business culture and growing domestic protectionism. Moreover, many organizations will be experiencing these risks for the first time.

## For most the No.1 priority remains organic growth.

Continuing the trend we saw in October, almost half (49%) of all companies are focused on organic growth, representing a 100% increase from 18 months ago. By contrast, only a third of companies say they are focused on M&A activity, a small increase on October 2010 but still a fifth fewer than 12 months ago.

**Which statement most accurately describes your organization's focus over the next six months?**

**Focused on organic growth**



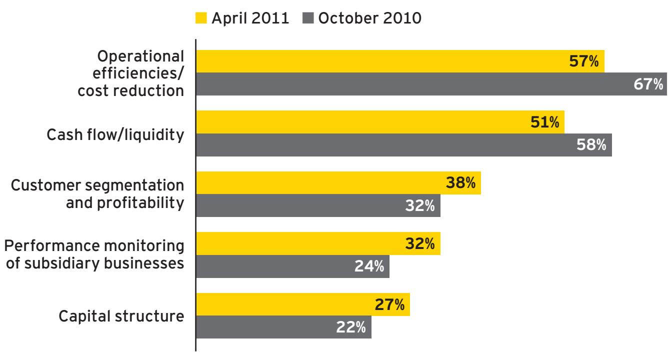

## Short-term fixes remain important, but the focus now is on building sustainable improvements.

In the aftermath of the financial crisis, leading companies took immediate protective steps to preserve cash and reduce costs. Companies are now focusing on improving long-term business performance.

In October 2010, two-thirds of companies were focusing their efforts on cutting costs and improving cash flow. While these remain key priority areas, the percentage of companies planning to give increased focus to them over the next 12 months is falling (from 67% in October 2010 to 57% now).

Companies are now moving on to the tougher challenge of building sustainable improvements into their business operations. Areas where they plan to invest greater effort include customer segmentation (38%), performance management of subsidiaries (32%) and optimizing capital structures (27%). There is also increased effort on acquisition integration and tax efficiency which doubled (from 6% to 14% and 5% to 10% respectively).

**Top 5 areas of focus for businesses over the next 12 months.**




## The two-speed boardroom.

The business outlook is improving for companies that have completed refinancing and started the work of optimizing their operations. But for those left behind, the opportunity to catch up could be disappearing fast. This polarization is clear.

While the majority of companies have refinanced their balance sheets and set a strategic course, 1 in 10 remain focused simply on survival. Such companies will increasingly find themselves with their options diminished. For some, their business model has been permanently impaired.

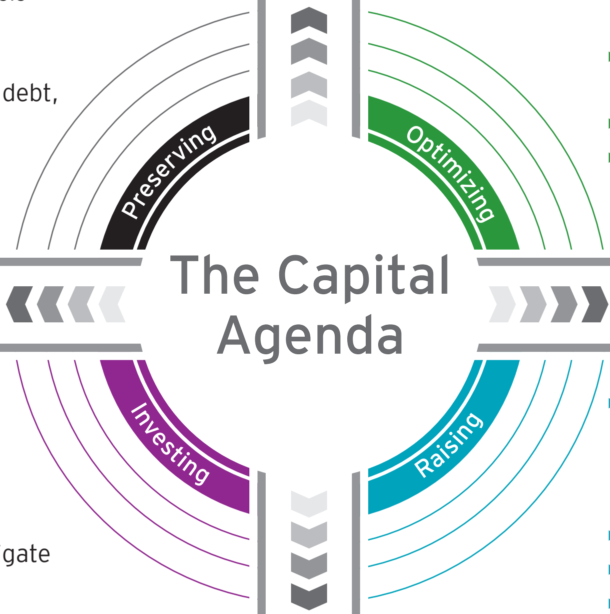
# Understanding your Capital Agenda

A strong Capital Agenda needs to be at the heart of all strategic boardroom and management decisions. The findings of our *Capital Confidence Barometer* provide useful insights into the ways companies are raising, investing, optimizing and preserving capital.

**Using the Capital Agenda will help companies consider their issues and challenges, and more importantly, understand their options to make more informed strategic capital decisions.**

- Stress and distress – e.g., liquidity issues and turnaround plans
- Customer and supplier analysis
- Preserving tax assets and minimizing costs
- Refinancing or restructuring debt, equity and other obligations
- Dealing with stakeholder relationships and pressure
- Dispute resolution

- Optimizing asset portfolio
- Delivery of synergies and effective integration
- Improving working capital and releasing cash
- Optimizing capital structure
- Optimizing tax and corporate structure

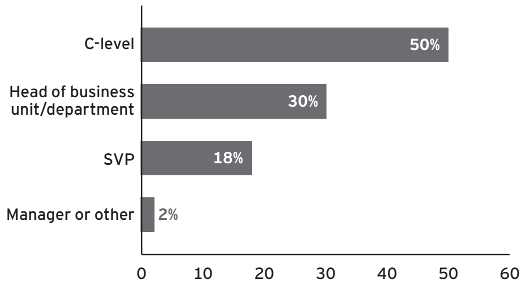



- Acquisitions and alliances
- Planning and structuring transactions to optimize stakeholder return
- Focused due diligence to mitigate risk and drive value
- Asset valuations
- Cost-and tax-efficient structures

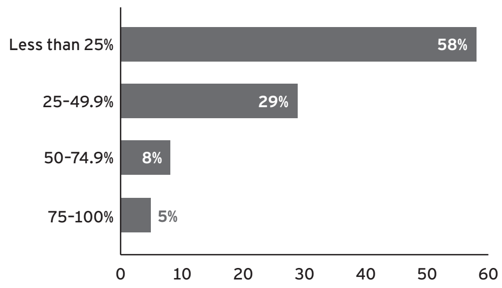
- Fundraising (equity and debt) IPO readiness, rights issues, PE, private placement and capital markets
- Optimizing funding structures
- Asset divestment
- Infrastructure projects
- Cost-and tax-efficient structures

# Survey demographics

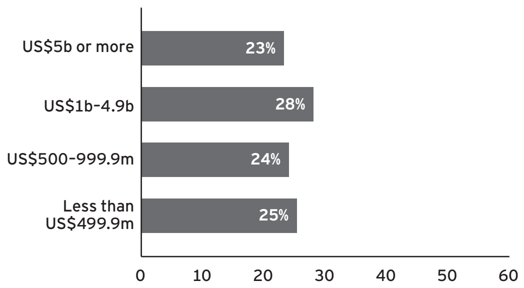
### What is your position in the organization?



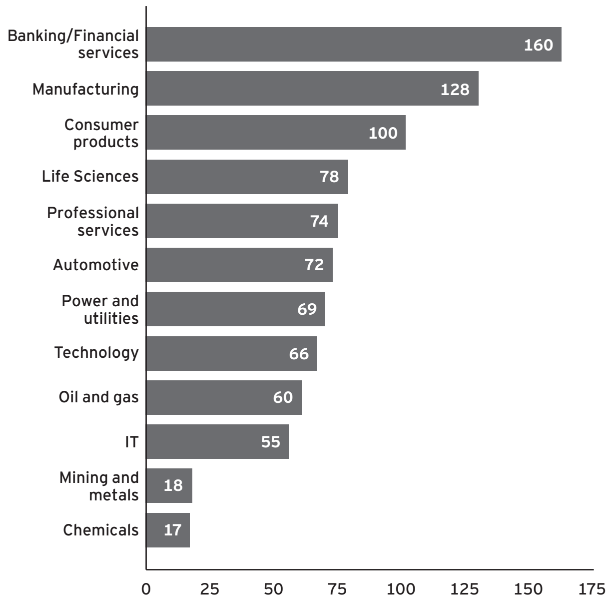

### What is your current debt-to-capital ratio?




### What are your company's annual global revenues in US$?




### In which industry is your company? (Number of companies)



# Contacts

If you would like to discuss your company's Capital Agenda, please contact your usual Ernst & Young advisor, or any of the contacts listed below.

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## Acknowledgements

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* The Ernst & Young 1,000 comprises an EIU panel of senior executives and selected Ernst & Young clients and contacts who participate in the Capital Confidence Barometer on a biannual basis. The surveys are conducted on an independent basis by the EIU.


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