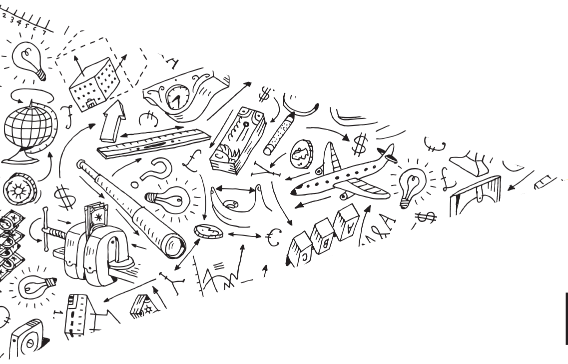
3rd Issue
October 2010

Capital Confidence Barometer



Looking for growth?

Our third *Capital Confidence Barometer* finds that while capital market conditions have improved since April, fewer businesses globally are considering mergers and acquisitions (M&A) in the next six months.

In April our second Barometer predicted the August surge in M&A activity in many markets – now we are seeing the appetite for M&A fall away, at least over the next six months.

In April, 38% were actively seeking M&A opportunities. That number has now dropped by a quarter even though boards are more able to respond quickly to acquisition opportunities, with only 16% restricted compared to 40% in our first study one year ago.

That is largely because growing optimism among executives about their own company and local economy prospects is dampened by increasing pessimism about the global economic landscape. Austerity measures, increasing regulation and currency conflicts are just some of the issues undermining confidence in the global economy. The result is a greater focus on organic growth (75% now see this as a priority) through performance improvement and further cost efficiencies.

Our unique global study around capital confidence continues to underline the critical fact that how organizations manage their capital today will define their competitive positions tomorrow. How they raise, invest, optimize and preserve their capital is absolutely critical in these challenging times, and the Barometer gives us a clear indication of C-suite plans to achieve these strategic goals over the next 6 to 12 months.

The insights from these C-level respondents tell us that the global downturn is not easing, leading to increasing investor caution. We see a two-speed recovery, with more robust confidence in emerging markets contrasted with greater caution in many mature markets.

Our latest findings also show a growing gap between the appetite to buy and the desire to sell. With fewer high-quality assets on the market we could see hostile approaches increase in the next six months. With cash war chests now available it could be the right time to make a strategic acquisition. There are inherent risks, but the rewards could be high. There may be a fall in the appetite for M&A, but we could see some bold competitive positioning.

These are some of the market opportunities – and challenges – of tomorrow.
The Barometer will help you prepare for them today.

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

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).

The respondent community, the "Ernst & Young 1,000", is comprised of an independent EIU panel of senior executives and selected Ernst & Young clients and contacts.

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 over 1,000 executives surveyed in September 2010
- Companies from 36 countries
- Respondents from 38 industry sectors
- 629 CEO, CFO and other C-level respondents
- 63 companies would qualify for the Fortune Global 100 based on revenues

The Capital Agenda

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

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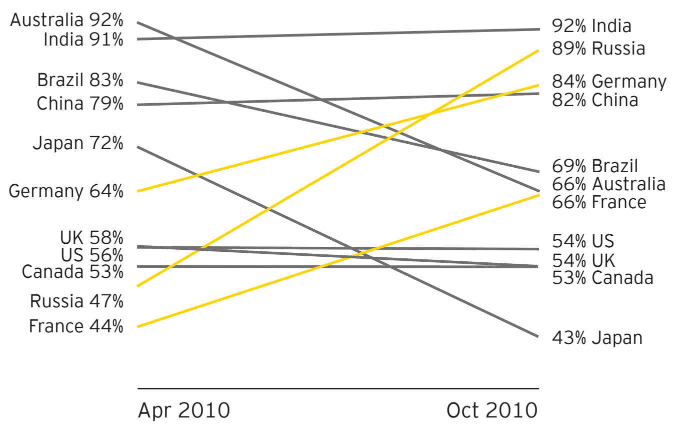
Key highlights

Despite improving capital conditions, global confidence has deteriorated, which is in turn leading to a decline in appetite for M&A. While many companies now have the resources to execute a transaction, fewer are actively looking to do a deal than six months ago. The Ernst & Young 1,000 are now focusing on organic growth and ensuring that their businesses are as lean and profitable as possible.

Economic outlook

- **Global downturn not easing.** Thirty-four percent of companies believe recovery will happen within the next 12 months, compared with 40% in April 2010. Most feel they will have to learn to operate efficiently in the existing market for some time to come.
- **Optimism increasing for local economies.** Sixty-seven percent feel more confident about the prospects for their local economy than six months ago. Levels of confidence in India and China remain high, but former confidence leader Australia drops out of the top five most confident economies. Russia and Germany enter the top five.

Optimism by country April 2010 to October 2010



Yellow highlight indicates those where confidence has improved by more than 5%

- **Fifty-nine percent of respondents expect the downturn in their own industries to end within 12 months.** Automotive, oil and gas and power and utilities show the highest confidence in improvement in industry prospects.

* BRIC = Brazil, Russia, India and China

73% of the Ernst & Young 1,000 feel more optimistic about prospects for their companies than six months ago.

Capital markets

- **Credit conditions for deals increasingly favorable.** Over half (58%) said credit/capital conditions were better now than six months ago. Access to capital to fund deals has also improved. A third of respondents (36%) state that access to funding is not a problem for their companies, compared to 26% in April.
- **Uneven picture of credit/capital conditions.** Globally capital availability is more varied. Among the BRIC* nations, the majority of executives said the situation had improved. But in the UK and US, only 33% and 47%, respectively, see such an improvement.
- **Deleveraging trend continues.** Forty-eight percent of all respondents said they need to refinance loan or debt obligations in the next four years – a decrease in the proportion that was in this position in April (58%). This is further evidenced by the 6% decline in the number of companies in the survey with a debt-to-capital ratio exceeding 50%.
- **Wall of refinancing remains.** There is less pressure to refinance in the next six months, as many have refinanced in advance of maturities. Nearly two-thirds of companies that do need to refinance said they have to do so within a year, virtually the same number as in April.

Mergers and acquisitions outlook

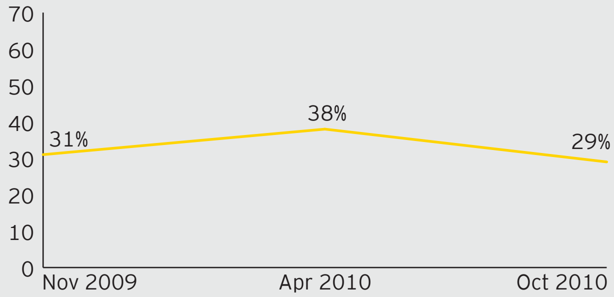
- **Downturn in global economic confidence reverses upward M&A trend.** Despite improving capital conditions and a decrease in the number of companies that said they were restricted in pursuing inorganic opportunities, those that are actively looking for an acquisition fell by a quarter (from 38% to 29%) in stark contrast to the strong appetite we saw between November 2009 and April of this year.
- **Trend for organic growth continues.** Nearly half (46%) of respondents said this was their focus over the next six months, compared to 38% in April and 25% in 2009. Seventy-five percent of companies say organic growth is their capital allocation priority. More management time will be spent on performance improvement and realization of operational synergies across their portfolios in the year ahead.

28% In the next six months 28% are likely to execute transactions, down from 47% in April.

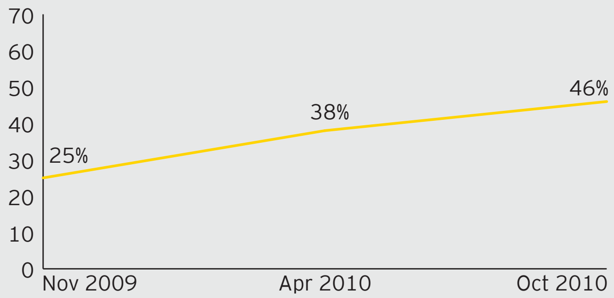
- **High growth markets attract acquisitions.** With low growth potential in developed markets, the emerging markets look increasingly attractive. Acquisitions in these nations show an upward trend, moving from 21% in November 2009 to 31% in October 2010. Joint ventures (JVs) and alliances are increasingly popular and the most likely market entry strategies.

Which statement best describes your organization's focus over the next six months?

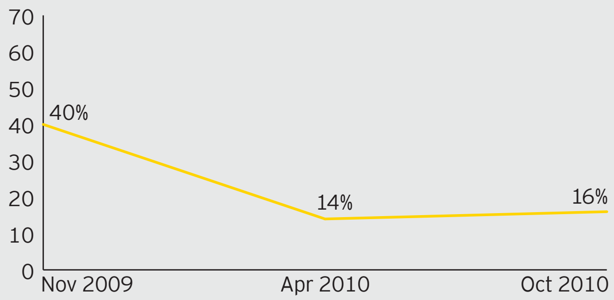
Actively looking to take advantage of M&A



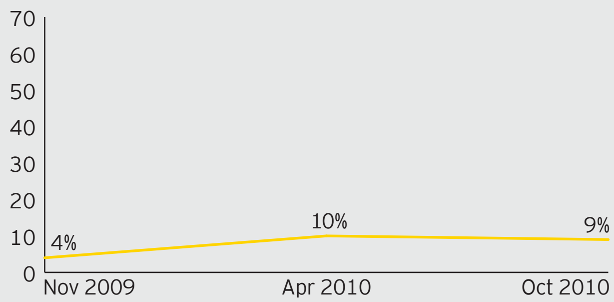
Focused on organic growth



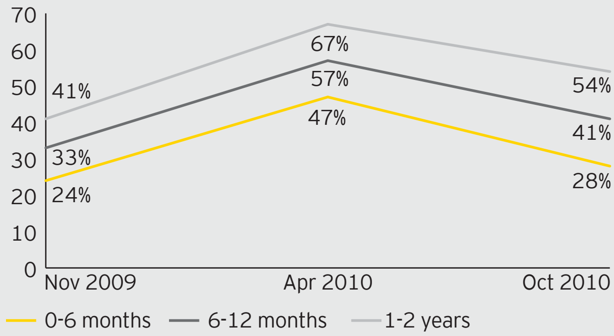
Restricted in ability to pursue inorganic opportunities



Focused on survival

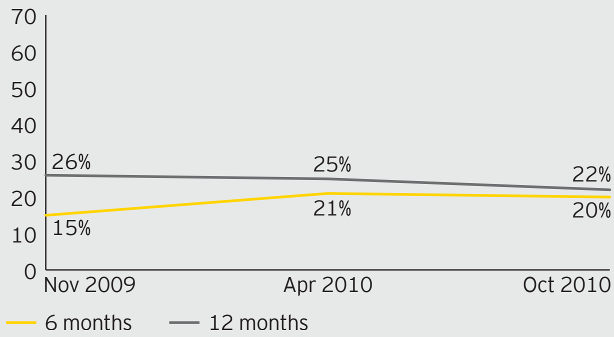


How likely is your company to execute acquisitions in the following time periods?

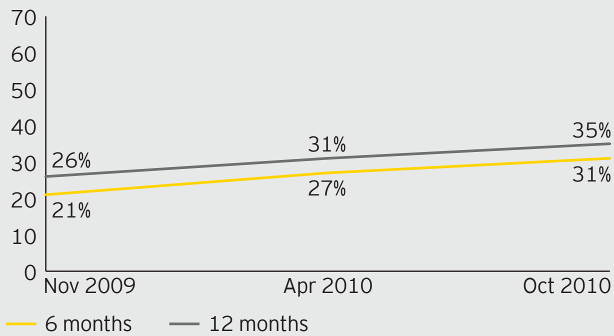


Which of the following are you likely to undertake or seriously consider in the next 6 and 12 months?

Acquisition in developed markets



Acquisition in emerging markets



Confidence

Preserving

Results

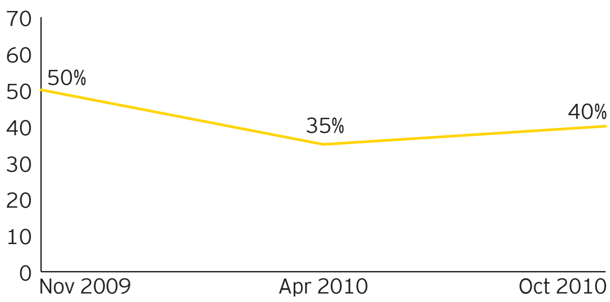
Preserving capital

Companies have been effectively preserving capital throughout the economic cycle and are now focused on achieving efficiencies and revenue growth in their core businesses. Many think that they can exploit the current conditions of improving financial markets and global opportunities only once they have put their houses in order.

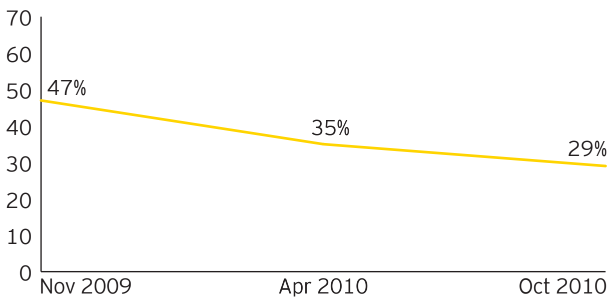
With a clear focus on organic growth, 40% of the Ernst & Young 1,000 said they needed to restructure their core businesses. Half of these plan to focus on performance improvement.

To what extent do you anticipate the need to restructure the following?

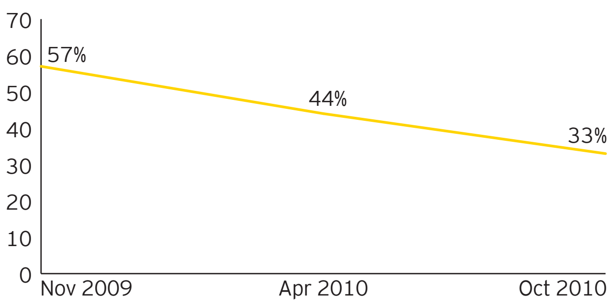
Great or greatest need to restructure core business



Great or greatest need to restructure a subsidiary/ non-core business before disposal

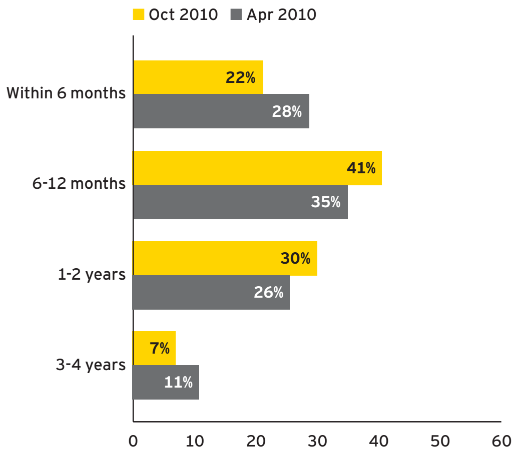


Great or greatest need to restructure an acquired business



Companies' increasing ability to invest in their businesses is fortified by easing access to finance. Low rates have made debt markets increasingly attractive, and banks are more willing to work with borrowers' circumstances. As a result, 52% of companies have no need to refinance loans or other debt obligations, an increase of nearly 10% on April 2010. Of the 48% of companies that do need to refinance, 63% plan to do it within the next 12 months.

How soon are you likely to refinance loans or other debt obligations?



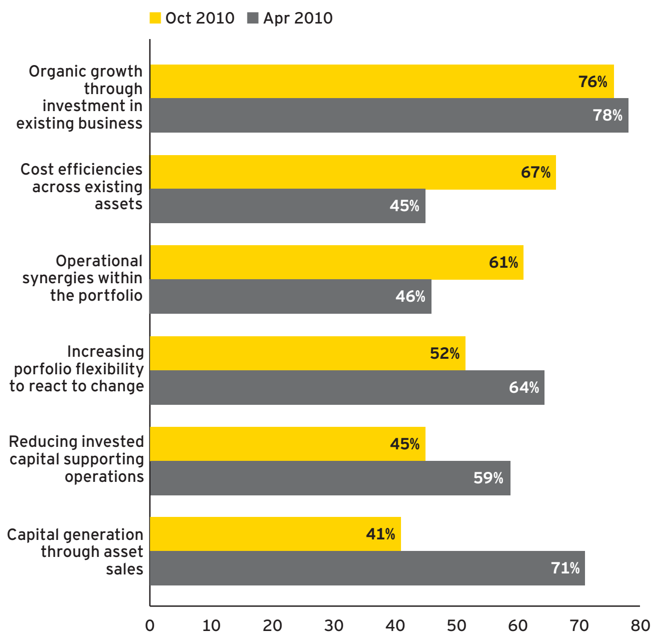
Optimizing capital

Organic growth will take up much of management time in the year ahead.

When asked to state their organizations' focus over the next six months, nearly half (47%) said organic growth, up from 38% in April.

Further, 76% said that organic growth through investment in existing businesses would be their priority when optimizing their asset portfolios.

In considering your asset portfolio which is considered the most important?



Optimizing

Raising

Cutting costs and finding efficiencies also show a strong upward trend, with 67% of respondents focusing on cost efficiencies across existing assets in the months to come, an increase of 22 percentage points from April. Cash flow and liquidity remain a priority, and there was a large increase (14 percentage points) in respondents that will address this challenge. Most companies have learned their lessons from the financial crisis and are continuing to do what they can to promote a culture of cash consciousness. Only 17% of the Ernst & Young 1,000 report they have made little or few efforts to improve cash and working capital practices.

When optimizing capital from transactions, realizing both financial and non-financial synergies fully and quickly remains important.

66% rank synergy identification and achievability as important or highly important when planning and structuring transactions.

Raising capital

Whether it's to finance organic growth, fund an acquisition or restructure a balance sheet, a company's ability to raise capital quickly and effectively is integral to its growth potential.

Access to funding is improving for many companies, particularly those companies with revenues in excess of US$5billion. Over the next 12 months, those that have excess capital are likely to view the M&A market opportunistically while still focusing on organic growth. For those that have not secured new financing or refinanced debt the prospect becomes increasingly difficult as capital becomes scarce and expensive. Some companies could become targets for acquisition.

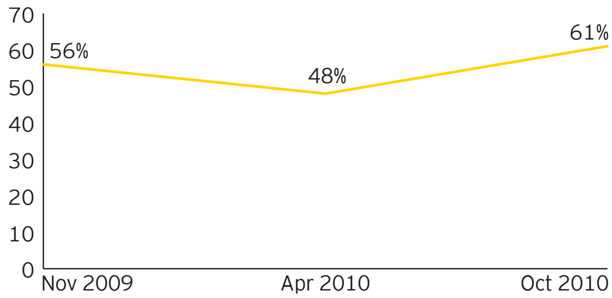
36% of the Ernst & Young 1,000 state that access to funding for capital projects is not a problem for their organizations.

52% say investor caution has increased in the current business environment and is now the biggest obstacle to future transactions.

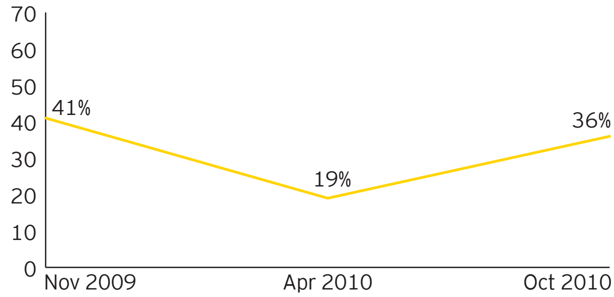
Cash still dominates deal financing, with 61% planning to fund deals with cash in the next 12 months. Except for bank loans, which have almost doubled to 36%, the use of other forms of debt and bonds has declined considerably.

What will be your main source of debt financing in the next 12 months?

Cash

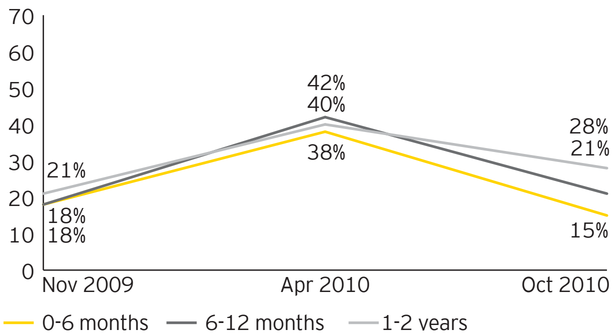


Bank loans



Divestments have decreased in popularity as a vehicle to raise capital. Valuation and pricing issues remain the major obstacle. Fewer respondents said they were likely or highly likely to make a divestment over the next six months (down to 15% from 38% in April). For the minority who plan divestments, selling to a third party or entering a JV or alliance was the preferred route. A successful sale to either will require companies to provide buyers with visibility of information on future earnings and cash flows as well as historic business performance.

How likely is your company to execute divestments in the following time periods?



Confidence

Investing

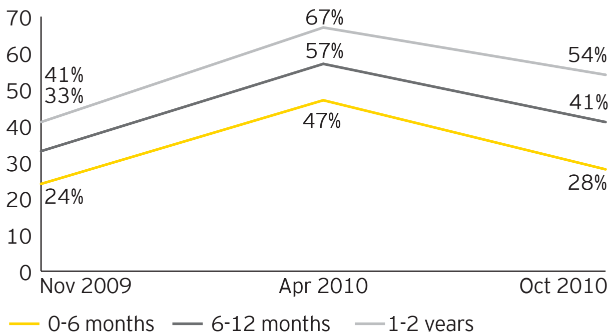
Investing capital

As the trend for companies to concentrate on organic growth increases, the Ernst & Young 1,000 have a lower appetite for M&A activity. But this may be a deliberate choice, as only 16% are restricted in their ability to pursue inorganic growth, compared to 40% a year ago.

However, healthy cash reserves are boosting confidence and it is likely that pent up appetite for assets may lead to unexpected competitive situations. Companies will need to act quickly, but with caution, if strategic transactions take place in their segments. The speed of the market can heighten the risk of the wrong asset being bought for the wrong reason at an inflated price.

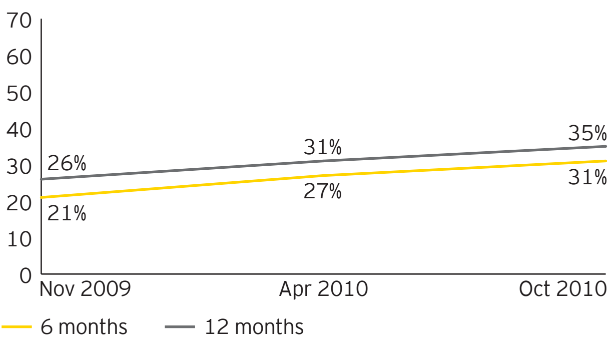
Investments that will be considered are those that fill a strategic gap – providing access to new product markets, geographies or distribution channels. A premium is likely to be paid for companies that can demonstrate they can be successful even in a slower market.

How likely is your company to execute acquisitions in the following time periods?



Most companies recognize the imperative for an emerging markets strategy to position them for future growth and plan M&A accordingly. A third (31%) said they were likely to undertake or seriously consider an emerging market acquisition in the next six months. By contrast, interest in developed markets acquisitions has remained flat over the last six months.

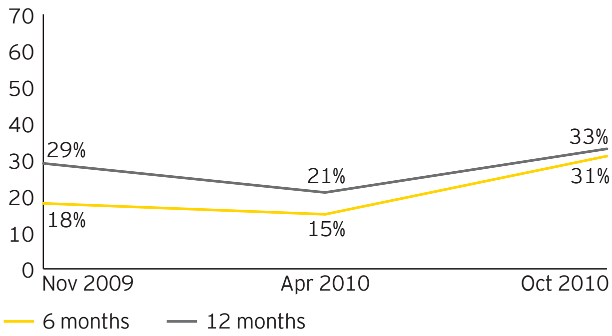
Acquisition in emerging markets



Over half of those who plan to invest in the emerging markets expect to enter via a JV or strategic alliances and this also shows an upward trend.

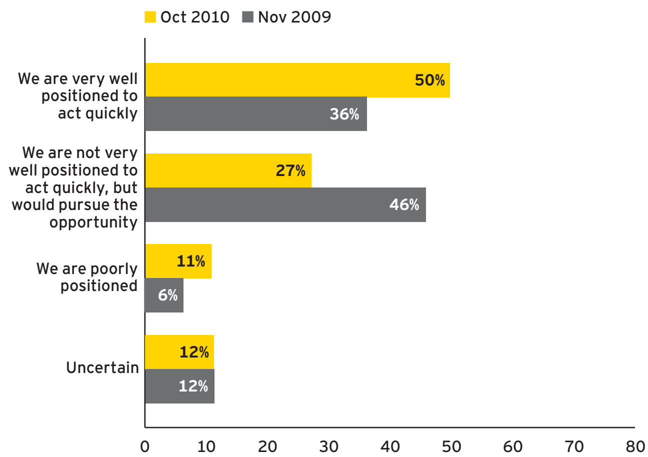
33% of businesses expect to enter into a JV or strategic alliance in the next 12 months.

Percentage of respondents likely or highly likely to undertake or seriously consider JVs and alliances in the next six and 12 months?



Over the last year, boards have responded to ongoing uncertainty by improving their ability to respond quickly to opportunities that may arise. Half of all respondents now feel well positioned to execute an acquisition at short notice, up from 36% in 2009.

How well is your company positioned (in terms of finance and decision-making) to execute an acquisition at short notice (within 30 days)?



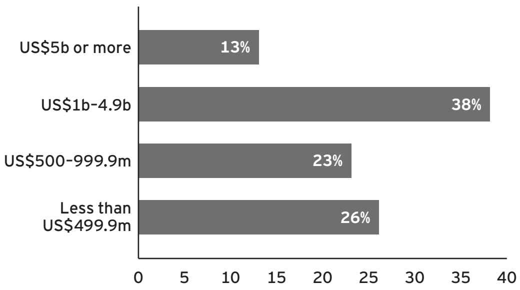
The top three issues that companies consider important when planning and structuring transactions remain the same: impact on capital structure, ability to identify and mitigate risk, and synergy identification. However, the big issue climbing the agenda was the potential impact of transactions on tax planning. The proportion saying this was an issue (61%) increased by seven percentage points from April. With most governments needing cash most corporates anticipate tax rates will rise.

Conclusion

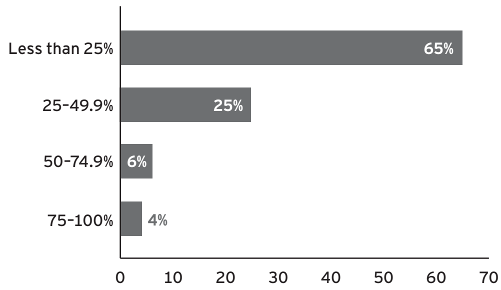
- Capital market conditions are improving for M&A as favorable cash and credit positions relieve funding restrictions on deals.
- Nevertheless, the appetite for M&A is declining for at least the next six months due to the uncertain global economic picture. More companies are reluctant to acquire or divest due to increased taxes, austerity measures and regulatory changes – among other issues – which are undermining confidence in the global economy.
- We see evidence of 'two-speed' recovery, with emerging markets ahead of developed counterparts and there remains a stronger appetite to acquire in high-growth markets.
- Overall, investor and boardroom caution over the next six months is driving a greater focus on organic growth – such as operational synergies and further cost efficiencies.
- Even though the survey predicts a fall in M&A overall for the next six months, as we noted in April, motivated and bold acquirers will use the continuing uncertainty to take first-mover advantage. Critically, more companies are now able to respond rapidly to opportunities than six months ago.
- Given the increasing gap between the number of potential buyers and willing sellers – and the reduction of quality assets in the market – we are likely to see a continuation of unsolicited bids.

Survey demographics

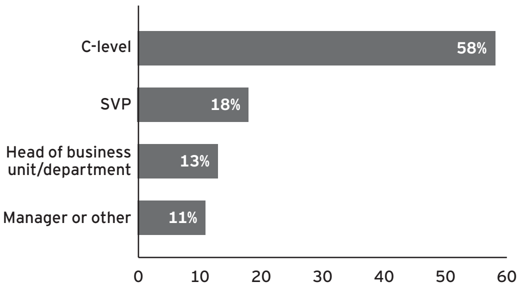
What are your company's annual global revenues in US$?



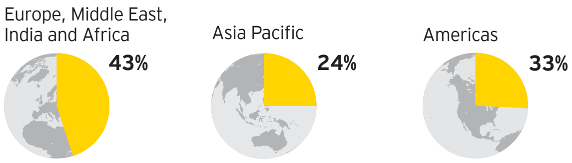
What is your current debt-to-capital ratio?



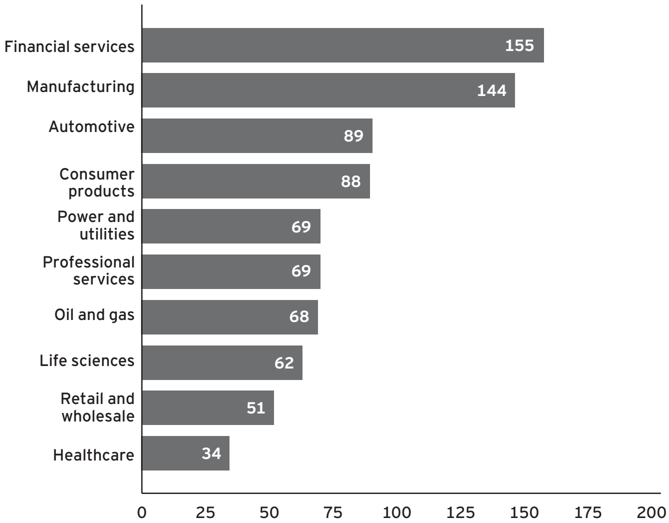
What is your position in the organization?



In which region are you located?



In which industry is your company?



Number of respondents, other sectors less than 30 respondents.

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.

Name	Telephone number	Email
Global		
Pip McCrostie Global Vice Chair Transaction Advisory Services	**+44 (0) 20 7980 0500**	**pip.mccrostie@uk.ey.com**
Steven Krouskos Global and Americas Markets Leader Transaction Advisory Services	**+1 404 817 5090**	**steve.krouskos@ey.com**
Michael Rogers Global Markets Transaction Advisory Services	**+44 (0) 20 7980 0200**	**michael.rogers@ey.com**
Americas		
Richard Jeanneret Americas Leader Transaction Advisory Services	**+1 212 773 2922**	**richard.jeanneret@ey.com**
Europe, Middle East, India and Africa (EMEIA)		
Joachim Spill EMEIA Leader Transaction Advisory Services	**+49 6196 996 25366**	**joachim.spill@de.ey.com**
Asia Pacific and Japan		
John Hope Asia Pacific Leader Transaction Advisory Services	**+852 2846 9997**	**john.hope@hk.ey.com**
Kenneth G. Smith Japan Leader Transaction Advisory Services	**+81 3 5401 6663**	**kenneth.smith@jp.ey.com**

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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