

**Deloitte.**



The Deloitte  
CFO Survey  
Navigating  
the challenges

Quarter 1 2010 results

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# About the survey and key findings

## About the survey

This is the third in our series of quarterly surveys of Chief Financial Officers of major Irish based companies. The survey was conducted in March 2010 and CFOs of listed companies, large private companies and Irish subsidiaries of overseas multi-national companies participated.

The Deloitte CFO Survey is the only survey that seeks to establish the views of CFOs in relation to the financial markets, economic outlook and business trends.

## Key findings

Key findings from this quarter's survey can be summarised under three headings:

### Continued optimism

- Compared to Q4 2009, CFOs are slightly more optimistic about the overall financial outlook for their companies, with an 8% increase on last quarter.
- When questioned on the performance of the ISEQ in 12 months time, the majority of respondents expressed the view that it would be higher than today.

### Banking and capital markets

- 60% of CFOs believe that NAMA will ultimately have some positive impact on the availability of credit; 52% indicated that it will have a positive impact in restoring the credibility of the banking sector.
- For businesses seeking capital, Irish banks are the least preferred method of external funding.
- CFOs do not see the supply of credit improving in 2010 but there is optimism among a majority that 2011 and beyond will see increased availability.

### Profitability and competitiveness

- Key priorities for CFOs are still revenue and profit growth/maintenance and cost reduction.
- 58% of respondents indicated that exchange rate risk has increased this quarter signalling expectations of higher euro volatility related to the Greek financial crisis, with 60% also expecting the dollar to strengthen against the euro in the next 6 months.
- There is consensus on the outlook for Irish interest rate movements with 92% expecting Irish lending rates to rise in the next 6 months.

## Quarterly roundup

Key events in Q1 2010 included:

January 13	IBEC estimates the freezing weather will cost the economy €300m
February 4	Finance Bill 2010
February 26	European Commission grant approval of National Asset Management Agency
March 3	Department of Social and Family Affairs publishes the National Pensions Framework
March 23	Government reshuffle
March 30	Provisional Joint Administrators appointed to Quinn Insurance (subsequently full Joint Administrators appointed)
March 31	Anglo Irish Bank publishes the biggest financial loss in the history of the State

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# Executive summary



The first quarter of 2010 has seen another series of developments that will impact on Ireland's economic recovery. On a positive note:

- There were high profile investments and job announcements by IBM, LinkedIn and eBay.
- Dublin Port reported the third successive monthly increase in trade through the State's principal port. Exports increased 10.7% in February when compared with the same month last year.
- Annual industrial production rose 13.7% in February according to the Central Statistics Office.
- The Central Bank, and a number of other economic commentators, have predicted a return to growth in GDP and GNP by the end of 2010, but still an overall decline in annual terms. For 2011 both GDP and GNP are predicted to increase.
- A 0.1% rise in consumer prices in March has eased fears of a deflationary trend.
- There were growing signs of economic recovery internationally, especially in the United States.

However, unemployment is projected to continue to rise through 2010 and increasing prices, coupled with the recently announced rise in mortgage interest rates by several lenders, will create challenges for consumers and businesses.

In February, the European Commission granted approval of the National Asset Management Agency (NAMA) and the first tranche of loans subsequently transferred to it. Interestingly, the valuations were lower than expected, and the certainty created seems to have been well received by the international bond markets, rating agencies and the international financial press.

In terms of the public sector and the political arena, continued industrial action and work to rule by public service unions reached a head when the Passport Office became the main focus of a public backlash to reduced services. At the time of writing, it looks as if many public sector unions are about to reject the National Public Sector Pay and Reform Agreement. The Government took a further knock with the resignation of three senior Ministers which led to a cabinet reshuffle. The

announcement of a general election in the UK for 6 May is an interesting development with potential implications for Ireland. In the Deloitte UK CFO Survey for Q1 2010, 56% of CFOs think a hung parliament would be negative for their business and 93% think it would be negative for the UK economy.

The appointment of provisional joint administrators to Quinn Insurance clearly sets out the intentions of the new Financial Regulator. While this event happened after our survey was completed it demonstrates the volatility that still exists in the market, and is a topic that we look forward to exploring later in the year.

## Optimism amidst the challenges

CFOs are positive regarding their own company's revenue and profits over the next 6 months with the expectation that turnover (69%) and profits (69%) will either increase, or at least stay the same. Compared to our previous survey, CFOs are slightly more optimistic about the overall financial outlook for their companies, with an increase to 32% predicting a return to growth in 2010. A positive but cautious outlook again points to a steady return to growth in the medium term.

## Credit availability

Irish bank funding is now the least preferred method of external funding for our CFOs. The cost and lack of availability of credit from these banks is the most likely cause for this. The top two preferred methods of funding for CFOs are now corporate bonds and overseas bank funding. Overseas bank funding has emerged as the most available source of finance compared to 6 months ago. CFOs do not see the supply of credit loosening in 2010 but there is optimism among a majority that 2011 and beyond will see an improvement.

## Banking sector and NAMA

There was a general welcome for NAMA - 60% of CFOs believe that it will ultimately have some positive impact on the availability of credit, and 52% indicated that it will have a positive impact in restoring the credibility of the banking sector. It will be interesting to see how this plays out over the rest of this year once more loans have been transferred and the economic effects start to trickle through.

### Exchange rate a key risk

Exchange rate risk emerged as a major concern over the last 12 months. Uncertainty in the international market and a slow EU response, coupled with a public backlash in Germany and France to the Greek financial crisis have resulted in exchange rate fluctuations. Many CFOs now expect to see further strengthening of the dollar against the euro. Uncertainty is further fuelled by the May elections in the UK, where there is speculation that a new government will devalue sterling to drive UK competitiveness.

### National Pensions Framework

When asked for reaction on changes to the National Pensions Framework, 35% of CFOs stated that they are in the process of closing an existing defined benefit pension scheme in light of the pension funding problems. Some CFOs' comments indicated they were closing their defined benefit scheme to new entrants with consideration being given to future benefit changes and switching to defined contribution schemes. This indicates a very rapid acceleration in the demise of pension benefit accruals under the defined benefit model.

### What to expect from next quarter

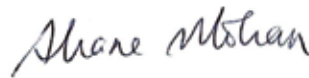
The first quarter of 2010 has seen a series of mixed signals in relation to economic recovery. There were some high quality inward investments

announced by the IDA; industrial production and international trade statistics are showing upward trends; and most economic predictions set the end of the year as the timeframe for a return to growth in GDP and GNP.

On the other hand, unemployment, increasing prices, a rise in mortgage interest rates and the potential for further public sector industry unrest will continue to be causes for concern.

The strength of the euro has been called into question with the slow and uncertain response by the EU to the Greek financial crisis. The full impact and resolution of this will hopefully become clearer over the next quarter.

A key question for next quarter's survey will be whether these positive developments can continue and so outweigh the threats to economic recovery.



Shane Mohan  
Partner, Deloitte

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# Survey findings

## 1. Optimism amidst the challenges

### Patterns in growth, turnover and profit

Figure 1 shows an 8% improvement in the number of CFOs predicting a return to growth in 2010. However, the majority predict a return to growth in 2011 and beyond.

Figure 1. Return to growth

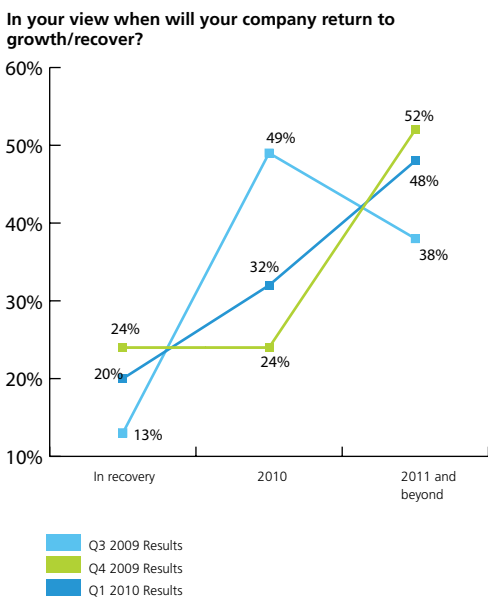
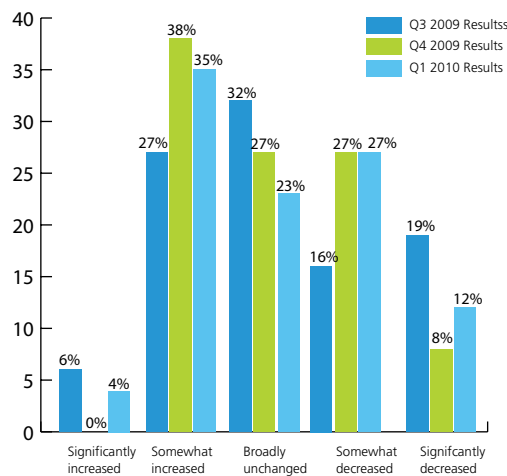


Figure 2 shows an increase of 4% in the number of CFOs who tell us that their company's turnover has significantly increased in the past six months. Confidence seems to have been somewhat restored since Q4 2009, when no CFOs reported significant increases in turnover.

Figure 2. Patterns in turnover over past 6 months

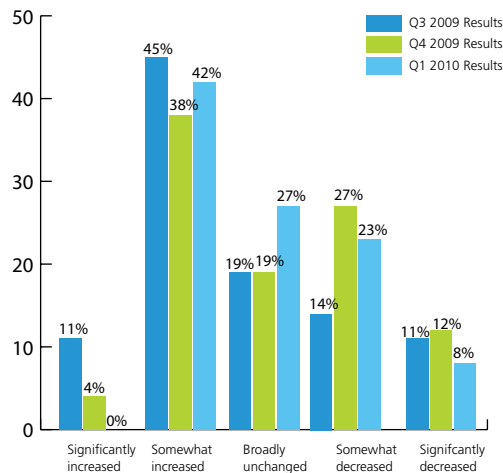
**Compared with 6 months ago how has your company's turnover changed?**



While figure 3 shows 42% of CFOs are predicting profits to somewhat increase, this graph also shows a fall of 11% in those who predicted significant increases this year back in Q3 2009.

Figure 3. Company's profit outlook

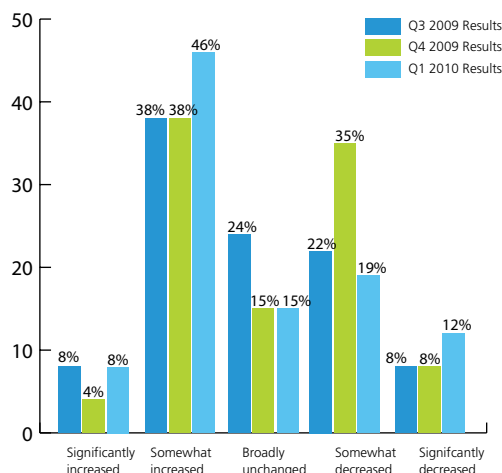
**How do you feel about the next 6 months compared to today with regard to company profits?**



In general, CFOs remain broadly positive regarding revenue and profits over the next 6 months; the majority of CFOs expect turnover (69%) and profits (69%) to either increase, or at least stay the same, over the next 6 months.

**Figure 4. Company's turnover outlook**

**How do you feel about the next 6 months compared to today with regard to company turnover?**

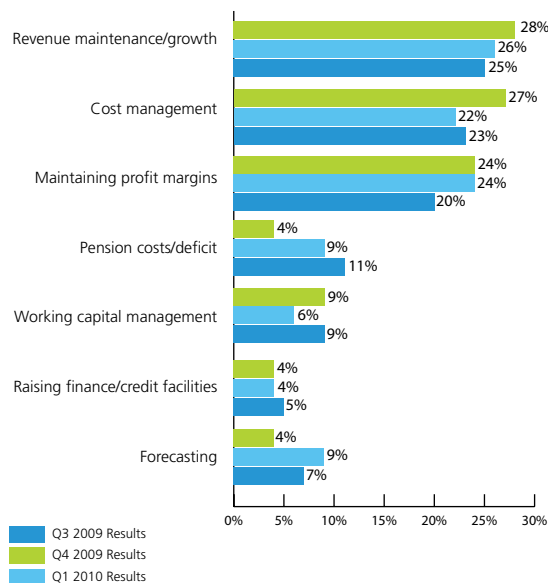


### Top financial challenges

Consistently, the top three priorities for the CFO remain the same as Q3 and Q4 2009; revenue maintenance/ growth, cost management and maintaining profit margins are the foremost concerns. Compared to Q4 2009, CFOs seem more comfortable with the current financial environment however cost management, showing a marginal increase in importance, will remain a key priority for the future.

**Figure 5. Top financial challenges**

**What are the top three financial challenges currently faced by your business today?**

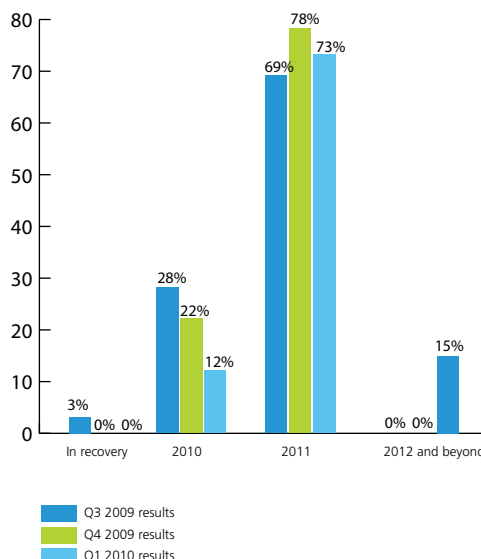


### Macro-economic outlook

Looking at a comparison of our last 3 surveys we can see that CFOs' outlook on entering recovery in 2010 has fallen from 28% to 12%. The outlook for a return in 2011 has remained more or less consistent, with only a small drop of 5% from Q4 2009 to 73% expecting a recovery in 2011. However, 15% of our CFOs do not predict an upturn until 2012.

**Figure 6. Economic recovery**

**In your view when will the economy enter recovery?**



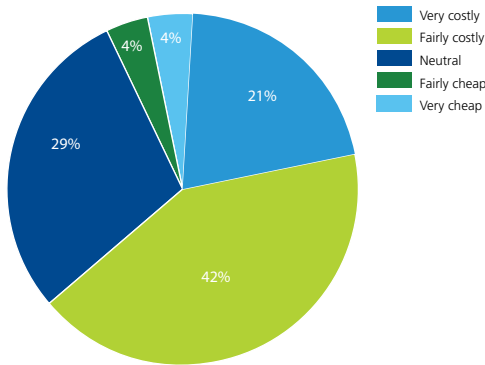
## 2. Still waiting for the release of Irish credit

Our survey results indicate that funding from Irish banks is now the least preferred method of external funding along with equities. CFOs do not see the supply of credit loosening in 2010 but there is optimism among a majority that 2011 will see an improvement. New equity issues seem to be off the table for the moment. An interesting trend over the last 12 months has been that the gearing ratios in the majority of companies has decreased and the trend looks set to continue into 2010. This is potentially due to a delay on capital spending as companies are reluctant to take on further debt, or the lack of availability of credit.

A majority (63%) of those surveyed indicated that the cost of credit for Irish corporates was either very or fairly costly.

**Figure 7. Cost of new credit for Irish corporates**

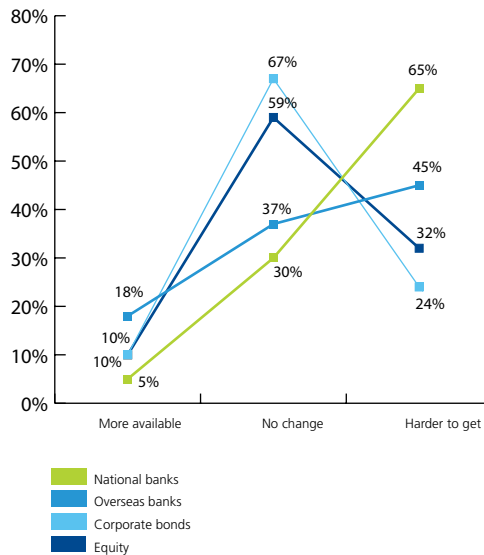
How would you rate the overall cost of new credit for Irish corporates?



The difficulty in obtaining new credit for Irish corporates from Irish banks is highlighted in Figure 8 with over 60% of respondents saying it is harder to acquire compared to 6 months ago. It will be interesting to see whether NAMA and capital injections will affect this figure in future quarters.

**Figure 8. Availability of credit**

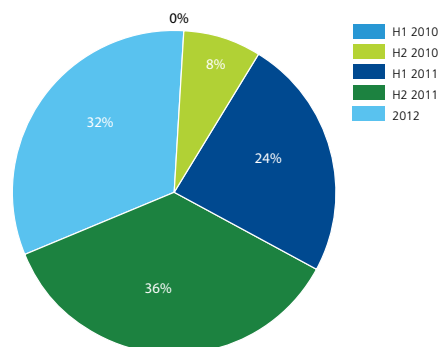
Availability of new credit for Irish corporates compared to 6 months ago



The vast majority of CFOs do not believe that they will obtain credit from Irish banks this year as only 8% believe credit will improve this year. Figure 9 also shows that 60% are more optimistic for next year when they forecast improvements in availability from domestic banks; 32% don't expect to see any improvements until 2012 at the earliest.

**Figure 9. Improvement in the supply of credit from national banks**

When do you expect to see an improvement in the supply of credit for your business from national banks?



Over 50% of CFOs said they are unlikely to look at issuing more equity to raise capital in the next 6-12 months. It is a mixed bag when it comes to debt with some CFOs saying it is likely and some saying it is unlikely. 50% indicated that it is likely they would issue debt in the next 6-12 months in contrast to only 25% who are considering equity.

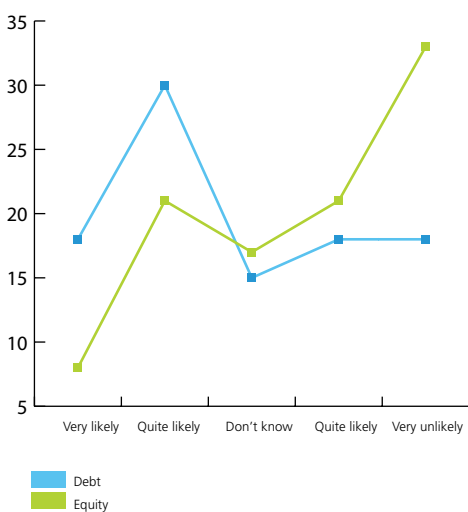
When asked, half of CFOs said their levels of gearing had decreased since last year. Since equity isn't being issued on the whole, this would infer that companies are reluctant or unable to take on additional debt with the availability and cost being the decisive factor.

This trend would seem set to continue as a majority of CFOs said they would continue to further reduce their level of gearing with only 12% aiming to increase it slightly going forward.

46% believe Irish Government Bonds are currently at a fair valuation while the rest are split on whether the valuations are under or overvalued. This would infer that most CFOs agree with the opinion of the major credit ratings agencies to downgrade the Irish credit rating.

**Figure 10. Debt/equity issuing**

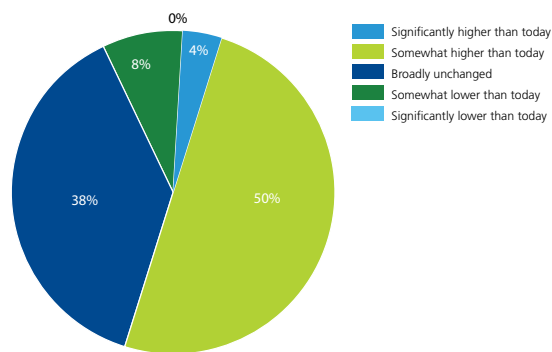
Over the next 6 - 12 months are you or is your parent company likely to issue debt or equity?



When asked for views on the ISEQ, 92% believed the market will be broadly unchanged or higher.

**Figure 11. ISEQ forecast**

In 12 month's time how do you expect the ISEQ to be?



...most CFOs agree with the opinion of the major credit ratings agencies to downgrade the Irish credit rating.

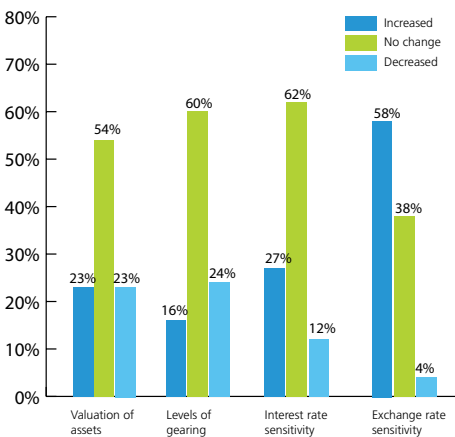
### 3. Exchange rate risk comes to the fore

This quarter's survey results show a significant increase in exchange rate risk over the last 12 months. The factors likely to have influenced this development are the crisis situation surrounding the Greek bailout and the quantitative easing tactics undertaken last year by the Bank of England affecting the volatility of sterling.

In the case of the valuation of assets, gearing levels and interest rate sensitivity, the majority of CFOs have reported no change in the level of risk to their financial statements from these areas.

Figure 12. Level of risk on your balance sheet or P&L

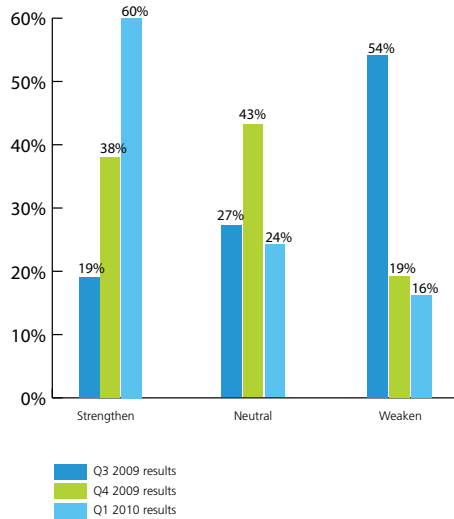
How has the level of risk on your balance sheet or P&L changed over the last 12 months?



There has been a considerable shift in CFO outlook particularly in relation to the euro's strength against the dollar; in Q3 2009, 54% of respondents said they expected the dollar to weaken against the euro while now 60% expect the opposite.

Figure 13. Quarterly 6 month outlook on US dollar against the euro

What is your outlook for US dollar exchange rate movements against the euro over the next 6 months?

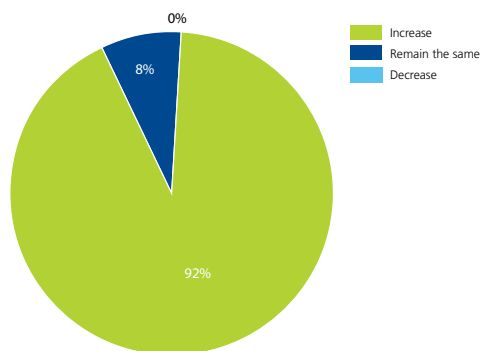


There has been a considerable shift in CFO outlook particularly in relation to the euro's strength against the dollar...

There is consensus among CFOs on their outlook for Irish bank lending rates in the coming 6 months with 92% agreeing an increase is likely, principally related to banks increasing their lending margins rather than increases in the underlying ECB rates.

**Figure 14. Six month outlook for Irish banking lending rates**

**What is your outlook for Irish bank lending rates over the next 6 months?**



Respondents believe that consolidation will have a significant impact on interest rates.

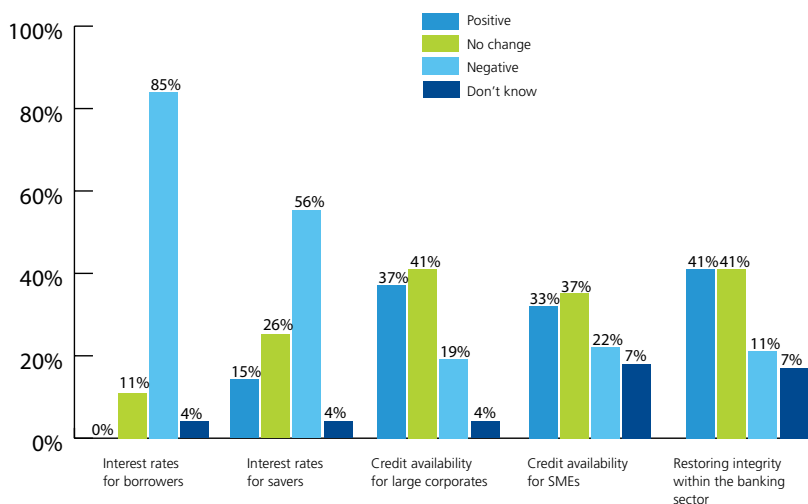
#### 4. Uncertainty in a changing banking landscape

With major change taking place across the State's banking landscape through government intervention and anticipated consolidation, our survey indicates an overall lack of confidence in the sector. The survey shows mixed reaction to these changes. This may well be linked to CFOs' expectations in Section 2 which indicate that the flow of credit will remain very limited until 2011 or beyond.

The potential for a 'third force' in the industry remains on the national agenda with the potential merging of a number of banks. Respondents believe that consolidation will have a significant impact on interest rates. The results in figure 15 show an expectation that, if there is consolidation, rates will move in a negative way for both borrowers (85%) and savers (56%), resulting in an increased spread between the rates as the cost of borrowing rises and the benefits of saving fall. The majority consensus is that there would be no impact on credit availability (78%) but the division of the responses on the whole indicate substantial uncertainty over the effects of the move.

**Figure 15. Bank consolidation**

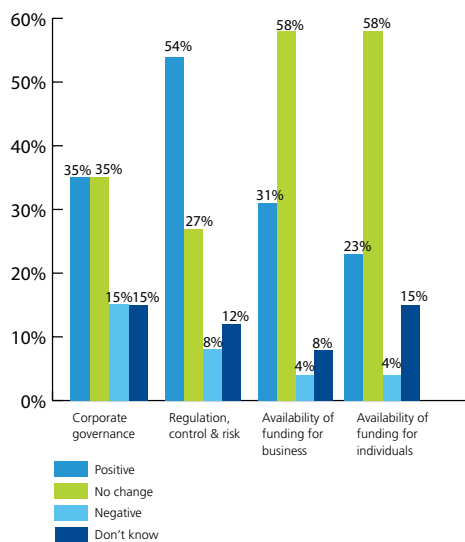
**If the anticipated consolidation takes place in the banking sector what do you think the impact will be on:**



A significant number of respondents (54%) see the Government's stake as a positive influence on control and risk management; however this move does little to boost confidence for the availability of funding where the majority consensus is for no change.

**Figure 16. Impact of the Government as a major stakeholder**

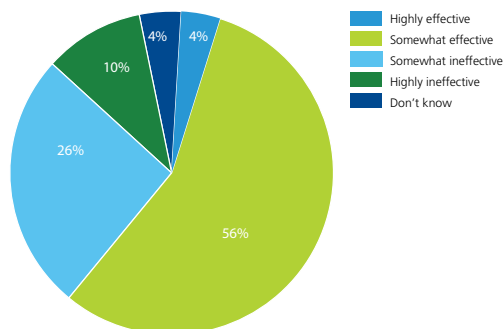
**With the Government as either the majority or only stakeholder in some of the banks what do you believe will be the impact on:**



A sizeable number of CFOs (60%) expect NAMA to be effective in increasing the availability of credit, however, 36% are still concerned the move will be ineffective.

**Figure 17. Effect of NAMA on availability of credit**

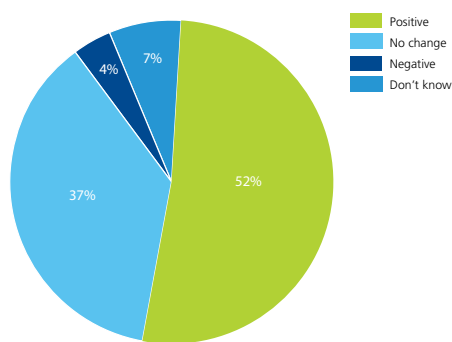
**How effective do you believe NAMA will be in enabling the banks to increase the availability of credit to business?**



As figure 18 shows, there is generally a positive belief (52%) that NAMA can restore integrity and credibility in the banking sector. However, 37% believe that it will have no effect and a further 4% believe it will have a negative effect. As the implications of NAMA become more apparent, it will be interesting to see if CFOs' views change over the coming quarters.

**Figure 18. Effect of NAMA in restoring integrity and credibility in the banking sector**

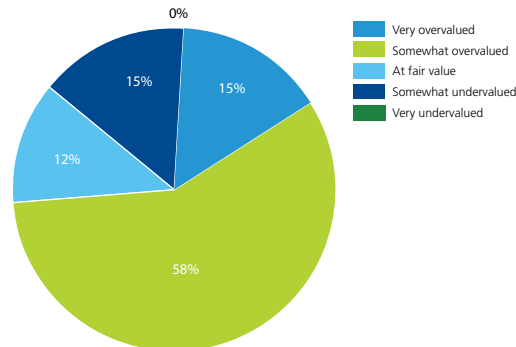
**How effective do you believe NAMA will be in restoring integrity and credibility in the banking sector?**



There is still uncertainty on the issue of real estate valuations. 73% of respondents said that they believe Irish commercial real estate is very or somewhat overvalued. It will be interesting to see the effect of NAMA valuations on this opinion going forward when the tangible effects filter through to the economy.

**Figure 19. Real estate valuations**

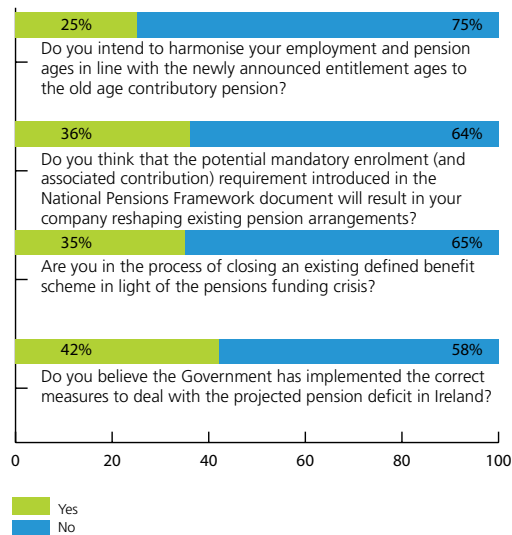
**How do you currently rate the Irish commercial real estate asset valuations?**



## 5. Reaction to the National Pensions Framework

Changes to the tax regime and legislative basis of the pensions provision in Ireland were announced by the Department of Social and Family Affairs in the form of the National Pensions Framework (NPF) on 3 March 2010. When asked about the macro effect of these measures, the majority (58%) of CFOs do not believe the Government has implemented the correct measures to bridge the projected deficit.

Figure 20. Reactions to changes to the National Pensions Framework



Despite the publication date of the National Pension Framework being very close to the survey, a surprisingly high 25% of CFOs already indicated that their company intends to harmonise the normal retirement ages of their employees in line with the rising state pension age. This is an area where we expect it to take a while before a clear picture of practice emerges. A change in the Pensions Act preservation regulations subsequent to the survey will make it somewhat easier for companies to increase the normal retirement age of their pension schemes.

Perhaps of most significant concern is the disclosure by 35% of CFOs' that they are in the process of closing an existing defined benefit pension scheme in light of the pension funding problems. Some CFOs' comments indicated they were closing their defined benefit scheme to new entrants with consideration being given to future benefit changes and switching to defined contribution schemes.

Bearing in mind that a lot of companies do not have an open defined benefit pension arrangement in the first place, this indicates a very rapid acceleration in the demise of pension benefit accruals under the defined benefit model.

There is a more mixed response in whether the Government has implemented the correct initiatives to address the projected pension deficit in Ireland - a small majority of respondents (58%) do not believe this to be the case.

When asked about the macro effect of the changes to the National Pensions Framework, the majority (58%) of CFOs do not believe the Government has implemented the correct measures to bridge the projected deficit.

# Conclusion

## What to expect from next quarter

The first quarter of 2010 has seen a series of mixed signals in relation to economic recovery. There were some high quality inward investments announced by the IDA; industrial production and international trade statistics are showing upward trends; and most economic predictions set the end of the year as the timeframe for a return to growth in GDP and GNP.

On the other hand, unemployment is projected to continue to rise through 2010, and increasing prices coupled with the recently announced rise in mortgage interest rates by several lenders will create challenges for consumers and business. The potential for further public sector industrial unrest is also a cause for concern.

The strength of the euro has been called into question with the slow and uncertain response of the EU to the Greek financial crisis. The full impact and resolution of this will hopefully become clearer over the next quarter.

A key question for next quarter's survey will be whether these positive developments can continue and so outweigh the threats to economic recovery.



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