

The Deloitte CFO Survey 2010: optimism, opportunity, risk



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This is the tenth quarterly survey of Chief Financial Officers and Group Finance Directors of major UK companies. The 2009 fourth quarter survey took place between 2nd and 16th of December. 128 CFOs participated including CFOs of 39 FTSE 100 and 47 FTSE 250 companies. The rest were CFOs of other FTSE companies, large private companies and UK subsidiaries of major companies listed overseas. The combined market value of the 97 UK listed companies surveyed is £473 billion, or approximately 28% of the UK quoted equity market. The Deloitte CFO Survey is the only survey of major corporate users of capital that gauges attitudes to valuations, risk and financing.

For copies of earlier CFO Surveys, see www.deloitte.co.uk/cfosurvey

The Deloitte CFO Survey

2010: optimism, opportunity, risk

Key points from the 2009 Q4 Survey

- CFO optimism has reached the highest level in two and a half years.
- The liquidity and funding crisis that gripped the UK corporate sector in early 2009 has eased.
- Credit conditions have improved but remain difficult.
- CFOs see equity and bond issuance as offering a far more attractive way to finance their business than bank borrowing.
- Cash flow and liquidity have receded as major concerns for CFOs over the last year. Nonetheless, reducing costs and increasing cash flow remain as top priorities for CFOs in 2010.
- CFOs are also implementing expansionary strategies to raise revenues and capitalise on a renewed growth.

CFOs are looking to 2010 in a more confident mood than might have seemed likely a year ago. Optimism about the financial outlook for their own businesses has risen to the highest level in more than two and a half years. The willingness to take financial risk, a key gauge of confidence, is running at similar levels to those seen in early 2008. Yet alongside these signs of confidence, CFOs continue to worry that the UK economy is going to experience a weak recovery. Two stories seem to be playing out, one about the financial sector and one about the economy.

On the one hand the degree of financial risk facing corporates has fallen as the financial system has stabilised. This partly reflects the effects of lower interest rates and support for the financial system in bolstering asset prices and liquidity. CFOs are finding it easier to raise external capital, especially from the equity and corporate bond markets, and concerns about the financial system have eased. The way in which CFOs choose to deal with the recession has also paid dividends. CFOs say that the strategies they adopted to control costs, boost cash flow and stay close to investors have been particularly successful.

The fruits of these strategies, coupled with an improving financial backdrop, help explain why liquidity and cash flow, two of the big worries cited in the fourth quarter 2008 Survey, have receded as major concerns for CFOs.

The change in the financial environment is not fully matched by improvements in the economy. Almost half of CFOs say that their main concern for 2010 is the state of the economy. Fears of a “double dip” are widespread and this explains the continued prioritisation of cash and cost control for CFOs. Credit conditions have improved, but remain difficult. Yet despite these risks and uncertainties, CFOs are starting to plan for growth. Revenue-raising strategies, including expansion into new markets, acquisitions and organic growth, now feature as prominent priorities for CFOs in 2010. Developing new products and services, an area which took a back seat in the recession, is now a priority for many CFOs. The great majority of CFOs expect M&A activity to rise over the next year.

The recession has proved much deeper than expected. Yet in a difficult environment corporates have demonstrated resilience. Corporate insolvencies have risen less than in the last downturn, in the early 1990s, while rates of return have remained stronger. CFOs understood that, for corporates, a financial crisis necessitated a strong focus on costs, cash and investor confidence. This response has paid off. Today the economy and the financial system are still a long way from normal – but, as the CFO Survey demonstrates, things are looking up. Corporates enter 2010 focused on cost control and improving cash flow – but also on expanding their revenues. These priorities testify to both the risks and the opportunities that CFOs see ahead.

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Priorities for 2010

While the worst effects of the recession appear to have passed, most forecasters expect to see a sluggish recovery in 2010. This quarter's CFO Survey sheds light on the strategies CFOs plan to adopt in what most expect to be a challenging environment.

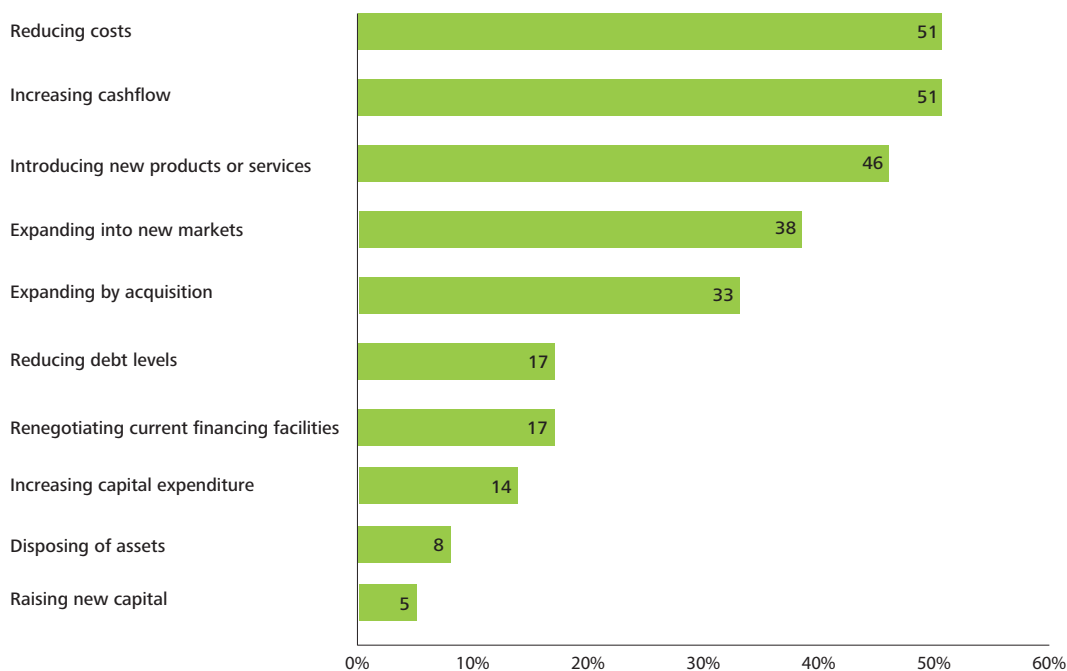
Effective control of costs and cash have been crucial in getting companies through the credit crunch and CFOs continue to see these controls as vital in the recovery. Thus two of the top three priorities in 2010 for 51% of our survey panel of UK CFOs are increasing cash flow and reducing costs. A year ago, in December 2008, at the low point in CFO sentiment, boosting cash flow was rated as CFOs' top priority for 2009, followed by improving investor confidence and reducing costs.

So while the economic outlook has improved significantly in the last year, CFOs remain focussed on what are relatively defensive strategies of reducing costs and husbanding cash. The low priority given to capital spending fits this picture and suggests that companies expect to be operating with spare capacity for some time.

But CFOs are also deploying a series of strategies designed to expand market share and increase revenues. The third priority for CFOs, marginally behind raising cash flow and reducing cost, is introducing new products or services. CFOs acknowledge that this area suffered as companies concentrated on dealing with the recession (see chart 3 on page 4). Expanding either into new markets or by acquisition are also widely cited priorities.

Chart 1. Priorities for 2010

% of respondents who have selected the following factors among their top 3 priorities



Methodology: We asked CFOs to select their top 3 priorities for 2010 from the list above. The score for each factor above is the percentage of CFOs that have included each factor in their top 3 priorities

Concerns and opportunities

We asked CFOs to tell us what they saw as the greatest concern for their business in 2010. 48% of CFOs identified the economy as their top concern with many citing fears of a double dip economic cycle. The next largest category related to political change, public borrowing, tax rises and cuts in public expenditure, with 14% of CFOs citing such worries.

CFOs' concerns have changed significantly in the last year. In December 2008, when we last asked this question, the answers were dominated by worries about shortages of liquidity and credit, with 55% of CFOs citing such threats. A year later there was only one reference to cash flow and not a single reference to liquidity. Today just 13% of CFOs cited wider concerns about the financial system. Indeed, the majority of CFOs, 78%, say that they believe the UK banking system is strong enough to sustain the recovery.

These responses suggest that the liquidity and funding crisis, which gripped the UK corporate sector in early 2009, has eased. Action by the authorities, in the form of interest rate cuts and aid to the financial system, has played a major role. So, too, has action by corporates in cutting costs, raising capital and husbanding cash. Economic uncertainty persists, but balance sheet and liquidity risks have reduced in the last year.

In terms of opportunities CFOs think 2010 offers the prospect of raising revenues through organic growth, expansion into new markets or by taking market share from weaker competitors. Many CFOs are also planning to make acquisitions. Cash and cost control remain priorities, but CFOs are also planning for revenue growth.

What do you see as the greatest concern for your business in 2010?

"A further dip down in economic activity."

"Uncertainty over UK economy."

"A prolonged economic downturn or a double dip Recession."

"A "W" shaped recession."

"Another leg to the economic downturn."

"Stalled economic recovery in the USA."

"A lack of capital and too tight debt markets."

"The stability of financial markets."

"Government inaction on public sector debt."

"The impact of regulatory and tax uncertainty."

What do you see as the greatest opportunity for your business in 2010?

"Introduction of new products."

"Launching new products and revitalising older products."

"Expansion into new markets."

"Organic growth in existing operations and projects."

"Growing cash flow from existing business."

"Growth through pursuing acquisitions."

"Taking share from overleveraged competitors."

"Increasing world demand."

"Expansion of overseas businesses."

"Asian growth given brighter economic outlook in this region."

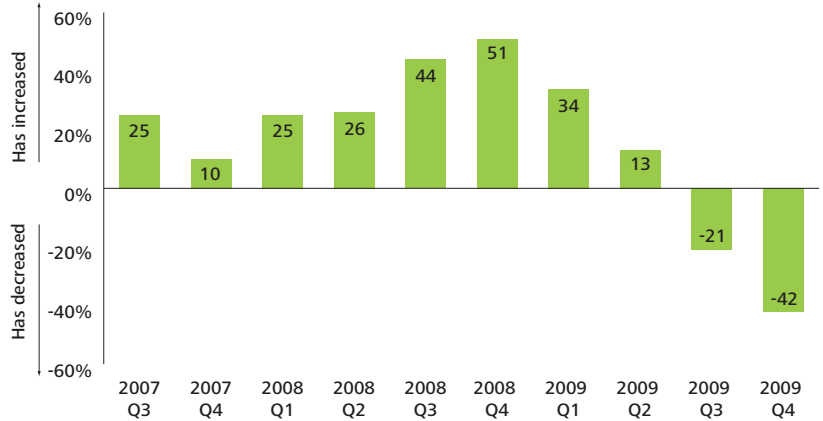
Sample of answers from 128 CFOs surveyed between 2 and 16 December 2009. For a more extensive list see page 8.

What went right in the recession

CFOs reacted to the credit crunch and the recession by reducing financial risk on their balance sheet, through, for instance, paying back debt and boosting cash reserves. After two years of rising balance sheet risk the third and fourth quarter 2009 CFO Surveys show that financial risk has declined.

Chart 2. Financial risk on company's balance sheet

Net % of respondents who said financial risk on their balance sheets has increased over the last 12 months



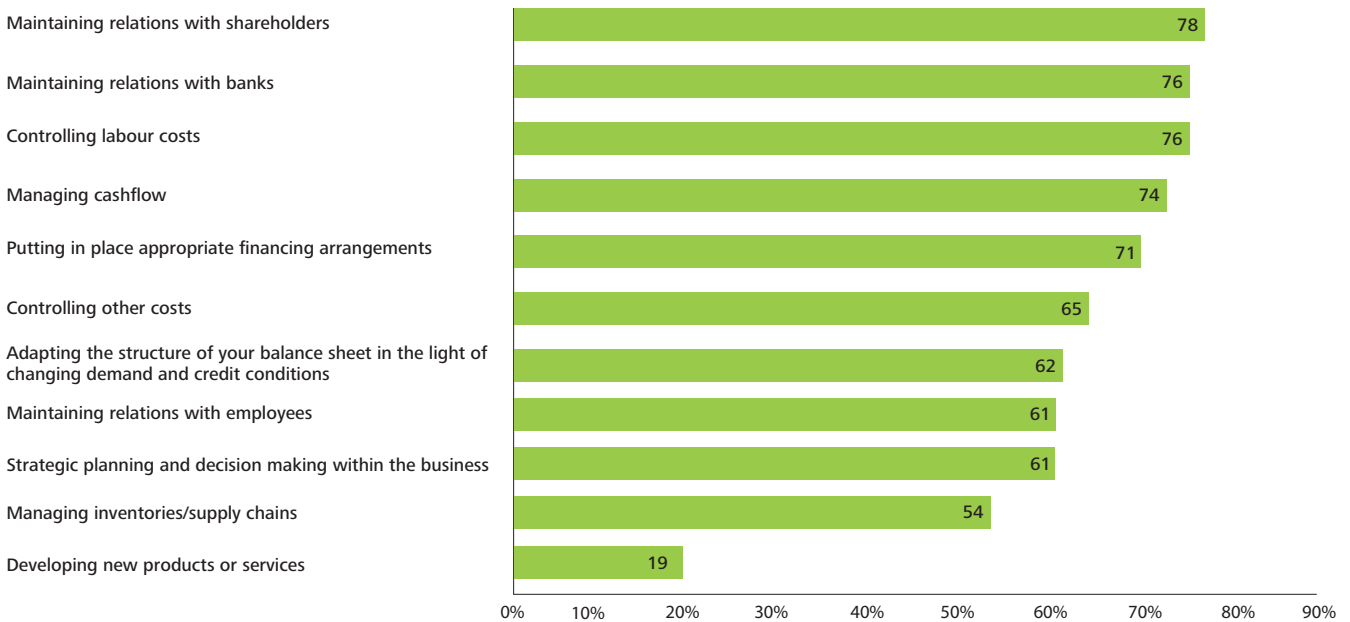
This quarter we asked CFOs to give their verdict on how their business has coped with the recession.

The greatest successes have been in maintaining relations with shareholders and banks, controlling labour costs and managing cash flow. These are precisely the strategies that CFOs identified a year ago, in the fourth quarter 2008 CFO Survey, as holding the key to surviving the recession.

The fact that balance sheet and liquidity risks have subsequently fallen suggests that CFOs have employed the right strategies for dealing with the downturn. As business sought to control costs, the development of new products and services seems to have suffered, but with the recession drawing to an end this area has become a priority for many CFOs (see chart 1, page 2).

Chart 3. How successful have companies been in dealing with the recession?

Measure of companies' performance in the following areas of their businesses (weighted*)



Methodology: The score for each area above is a weighted average of CFOs' responses. A score of +1.0 is given for "very successful", +0.5 for "successful" and -1.0 for "unsuccessful".

Optimism and resilience

Despite widespread concerns among CFOs about the speed of the recovery, their optimism about the financial prospects of their own businesses has continued to rise. In December financial optimism reached the highest level since the Survey started more than two years ago.

Chart 4. Financial prospects

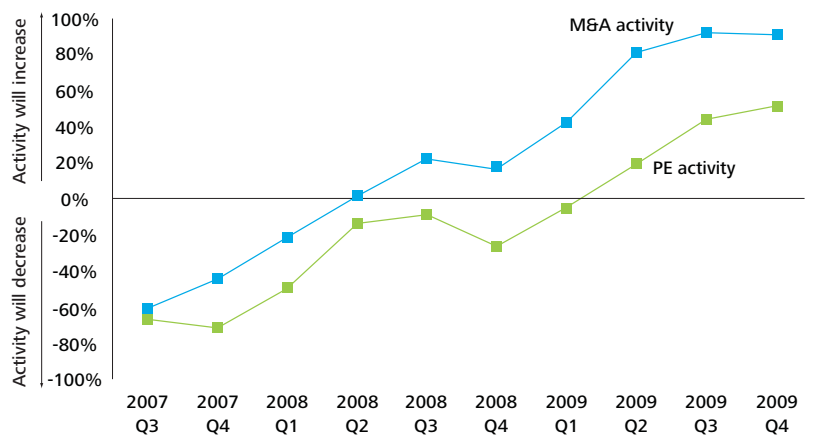
Net % of CFOs who are more optimistic about financial prospects for their company now than they were three months ago



CFOs were quick to identify corporate activity as being one of the opportunities that would emerge from the recession. A year ago in response to a special question almost three quarters of CFOs said that they thought the downturn would provide opportunities to acquire companies or other assets at a discount. Since then optimism among CFOs about corporate and private equity activity has been on a rising trend. The great majority of CFOs expect corporate activity to rise over the next year.

Chart 5. M&A and PE outlook

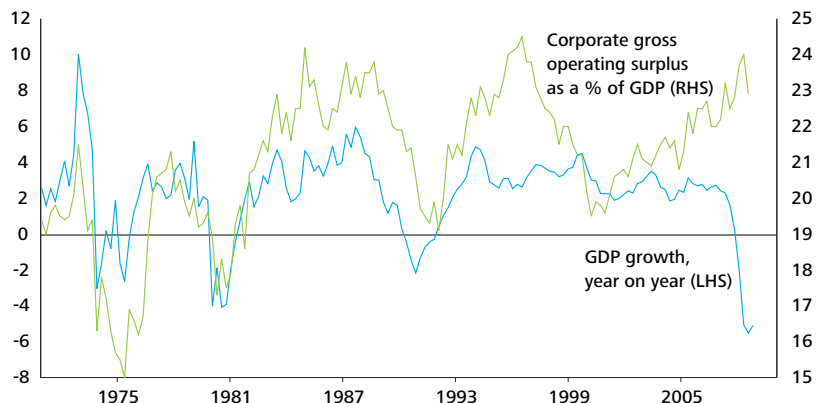
Net % of CFOs who expect M&A and PE activity to increase in the next 12 months



Business has been pretty effective in shifting excess stocks, husbanding cash and controlling costs during the downturn.

Chart 6. Corporate profits have proved resilient

UK GDP growth vs corporate profits



Official data confirm that companies have demonstrated resilience. Corporate insolvencies have risen far less than in the last recession, in the early 1990s. And, as the chart illustrates, rates of return for corporates remain well above those seen in the last recession.

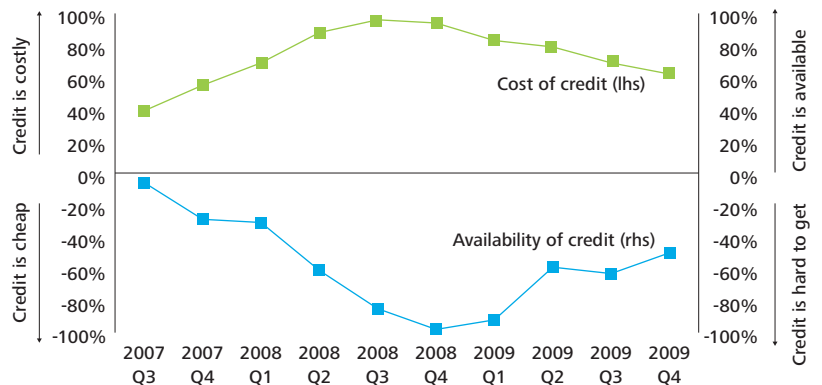
Source: Office for National Statistics

Financing the corporate sector

The stabilisation of the financial sector over the last year has led to a gradual improvement in the cost and availability of credit for corporates. Nonetheless credit conditions for corporates are more restrictive than they were in 2007.

Chart 7. Cost and availability of credit

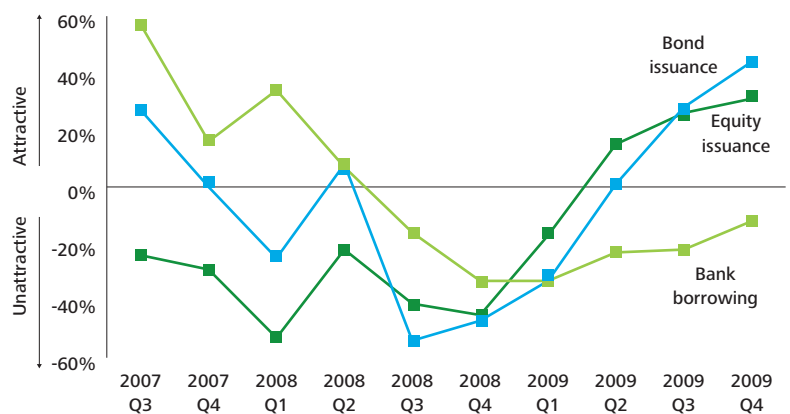
Net % of respondents reporting credit is costly and credit is easily available



The credit crunch has taken bank credit from the most attractive to the least attractive form of finance for corporates. However, bank credit has become marginally more attractive to CFOs in the last year, pointing to some thawing in this market.

Chart 8. Favoured sources of corporate funding

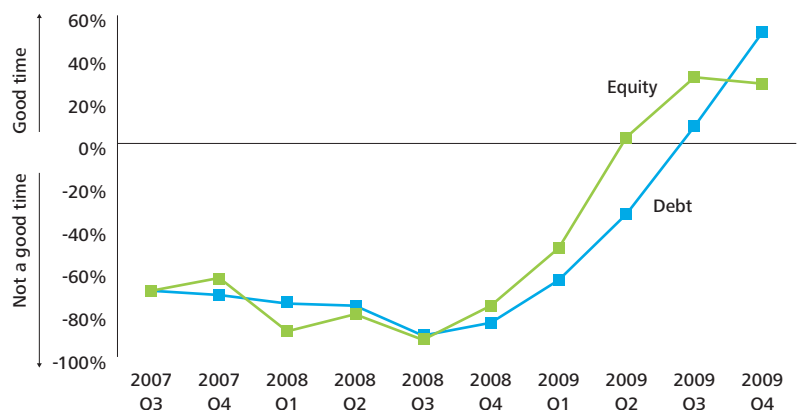
Net % of respondents reporting the following sources of funding as attractive



But for many corporates, particularly larger companies, equity and bond issuance have proven to be a far more attractive way to finance their business.

Chart 9. Good time to tap capital markets

Net % of respondents who think it is a good time to issue equity/debt



With CFOs positive on such issuance it seems likely that the wave of equity and bond issuance seen in 2009 will continue into 2010.

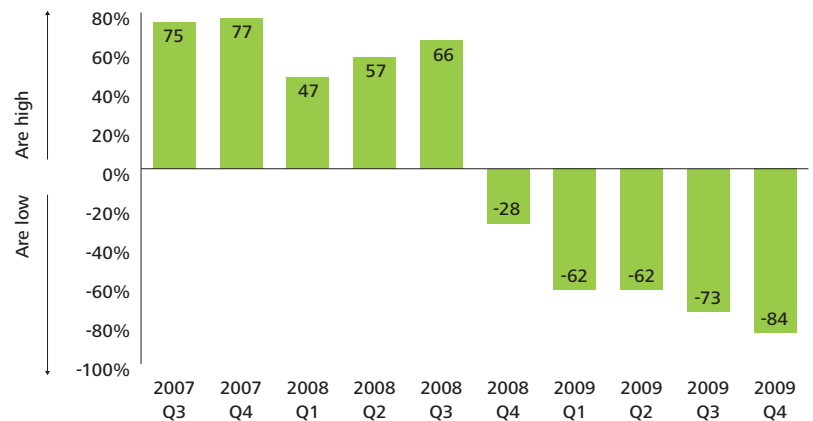
Reducing risk aversion, rising equity valuations

The overwhelming majority of CFOs think market interest rates are at low levels.

The pace of the recovery will depend partly on the extent to which banks transmit low market interest rates to corporates and households.

Chart 10. Short term interest rates

Net % of respondents who think short term interest rates are high

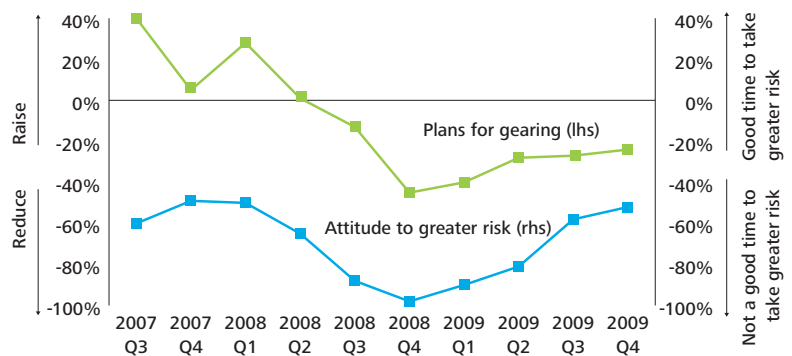


CFOs remain wary of taking financial risk or raising gearing, signified in the chart by negative balances on both series.

However, the value of survey data often lies in the direction of change rather than the absolute level of an indicator. Over the last year CFOs have become less averse to increasing borrowing and to taking financial risk. Indeed, willingness to take financial risk has returned to similar levels to those seen in early 2008 when the general expectation was for a modest slowdown in global growth. However, with the economy and financial sector in a very different position today the actual degree of risk-taking seems likely to be different.

Chart 11. Plans for gearing and attitude to greater risk

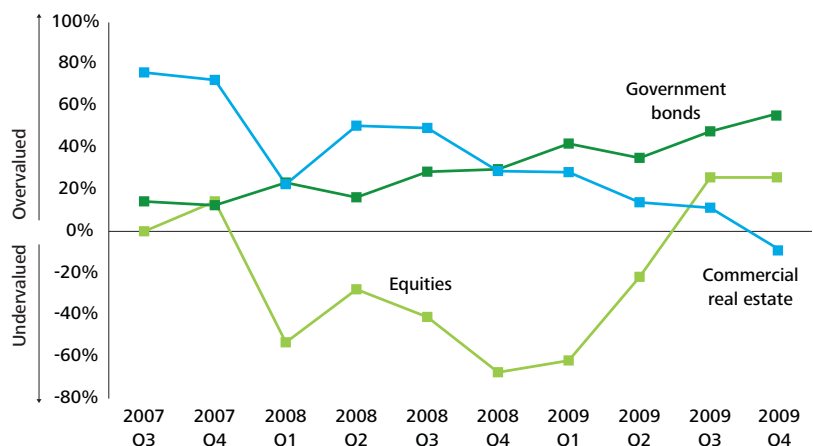
Net % of CFOs who think it is a good time to take greater risk onto their balance sheets vs Net % who are planning to raise their level of gearing



CFOs' views on asset valuations have changed significantly in the last year. CFOs see both Government bonds and equities as being overvalued. Meanwhile commercial real estate has gone from being seen as the most overvalued asset in 2007 to the most undervalued asset today.

Chart 12. UK valuations

Net % of respondents who think the following assets are overvalued



Greatest opportunities and concerns in 2010: quotes from CFOs*

Greatest concerns

"A further dip down in economic activity."
"Uncertainty over UK economy."
"A prolonged economic downturn or a double dip recession."
"A "W" shaped recession."
"Another leg to the economic down turn."
"Stalled economic recovery in the USA."
"A lack of capital and too tight debt markets."
"The stability of financial markets."
"Government inaction on public sector debt."
"The impact of regulatory and tax uncertainty."
"Interest rate increases."
"Rapid increase in short rates."
"Deflation."
"Further dip down in economic activity."
"Double dip recession."
"Prolonged recession or double dip triggered by increased taxation."
"A flip back into recession."
"Stagnation of the world economy."
"Political positioning in an election year could inflict lasting damage on the UK's financial services sector."
"Late cyclical impacts of recession."
"Macro economic headwinds."
"Deeper economic recession and slow recovery, especially in the UK."
"A sterling crisis and the inability of the government to deal with the fiscal position."
"Government inaction on public sector debt."
"Uncertainty around and potential impact of regulation"
"Lack of confidence in government and banks."
"Further prolongation of financial crisis."
"Downward customer pricing pressures."
"Winning sufficient new work to avoid further staff reductions."
"Level of operating gearing in the business, resulting in depressed margin."

Greatest opportunities

"Introduction of new products."
"Launching new products and revitalising older products."
"Expansion into new markets."
"Organic growth in existing operations and projects."
"Growing cash flow from existing business."
"Growth through pursuing acquisitions."
"Taking share from overleveraged competitors."
"Increasing world demand."
"Expansion of overseas businesses."
"Asian growth given brighter economic outlook in this region."
"Expand successful products into new markets."
"Organic growth in Asian markets."
"More normal capital expenditure environment."
"Developing new lines of business."
"We are cash rich so investing in new business."
"Investing in new product in time for a recovery of markets."
"Recovery in commodity prices."
"Distressed property assets being sold by banks."
"Exploiting increased business confidence which will increase our revenues."
"Inorganic and organic growth of our Wealth Management business."
"Potential acquisition opportunities as pricing expectations normalise."
"Opportunistic acquisitions resulting from market dislocation."
"Acquisitions in Europe."
"Market share gain from a weakened competitors."
"Restocking and general recover in OECD demand."
"A sustained economic recovery."
"New markets."
"Developing new lines of business."
"Public sector change will drive outsourcing demand."
"Capitalising on the strength of our balance sheet at a time when many competitors have very limited financial fire power."

* a representative selection of responses from CFOs to the following questions: What do you see as the greatest opportunity for your business in 2010? What do you see as the greatest concern for your business in 2010?

Data archive

A note on methodology

Many of the charts in the Deloitte CFO Survey show the results in the form of a net balance. This is the percentage of respondents reporting, for instance, that bank credit is attractive less the percentage saying bank credit is unattractive. This is a standard way of presenting survey data used by, amongst others, the CBI and the European Commission. To aid interpretation of the results, this table contains a full breakdown of responses to the questions covered in this report. Due to rounding answers may not sum to 100.

	Q3 2007 %	Q4 2007 %	Q1 2008 %	Q2 2008 %	Q3 2008 %	Q4 2008 %	Q1 2009 %	Q2 2009 %	Q3 2009 %	Q4 2009 %
How would you rate the overall availability of new credit for corporates?										
Available	42	26	31	16	5	1	2	13	11	19
Neutral	10	19	6	7	6	0	4	15	16	13
Hard to get	48	55	63	77	89	99	94	72	73	69
Net balance	-6	-29	-31	-61	-84	-98	-92	-59	-63	-50
How would you rate the overall cost of new credit for corporates?										
Costly	59	64	72	89	97	95	86	82	76	73
Neutral	22	26	25	10	2	4	11	15	18	16
Cheap	20	10	3	1	1	1	3	3	7	11
Net balance	39	55	69	88	96	94	83	79	69	62
Bank borrowing, as a source of funding, is										
Attractive	73	44	59	47	35	29	27	27	26	31
Neither attractive nor unattractive	12	28	16	13	14	9	12	22	27	26
Unattractive	16	28	25	40	51	62	61	50	48	43
Net balance	57	16	34	7	-16	-33	-34	-23	-22	-12
Corporate debt raising, as a source of funding, is										
Attractive	55	33	28	40	14	20	22	35	48	58
Neither attractive nor unattractive	18	33	19	29	17	14	23	32	33	29
Unattractive	27	33	53	31	68	66	55	34	19	13
Net balance	27	0	-25	8	-54	-46	-33	1	28	44
Equity raising, as a source of funding, is										
Attractive	26	19	19	29	17	21	27	44	50	48
Neither attractive nor unattractive	24	33	9	20	24	13	28	26	26	28
Unattractive	50	48	72	51	58	66	45	30	24	23
Net balance	-24	-29	-53	-22	-41	-45	-18	14	26	25
UK corporate balance sheets are										
Overleveraged	4	5	13	32	33	38	63	50	39	40
Appropriately leveraged	65	73	81	61	61	59	34	44	57	56
Underleveraged	31	22	6	7	6	3	3	5	4	5
Net balance	-27	-17	6	24	27	35	60	45	34	35
Cash return to shareholder ratios (including share buybacks) are										
High	41	35	32	17	15	25	15	9	6	5
Normal	49	60	52	56	39	26	13	22	26	29
Low	10	5	16	27	45	49	72	68	68	66
Net balance	31	30	16	-10	-30	-24	-57	-59	-62	-61
In a year's time, FTSE 100 will be										
Higher	45	30	50	40	49	66	65	61	38	45
Broadly unchanged	33	40	25	33	35	26	23	34	49	42
Lower	22	30	25	28	16	8	12	4	13	13
Net balance	24	0	25	12	33	58	53	58	26	31
Levels of M&A in the UK will										
Increase	14	21	31	38	48	40	56	83	92	91
No change	12	14	16	26	27	36	29	15	8	9
Decline	75	65	53	37	26	24	15	2	0	0
Net balance	-61	-44	-22	1	22	16	41	81	92	91
Volume of acquisitions by private equity in the quoted equity market will										
Increase	14	12	22	32	31	20	29	40	50	58
No change	6	5	6	23	30	33	37	40	45	36
Decline	80	84	72	45	39	47	34	21	6	6
Net balance	-67	-72	-50	-13	-8	-27	-5	19	44	52
Compared with three months ago how do you feel about the financial prospects for your company?										
More optimistic	26	17	22	17	3	7	15	37	46	46
Unchanged	44	43	47	47	41	27	40	49	46	52
Less optimistic	30	40	31	36	56	66	45	15	8	2
Net balance	-4	-24	-9	-19	-53	-59	-30	22	38	44

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