

CFO insights: Capital Ideas – Insights from CFO vision 2009

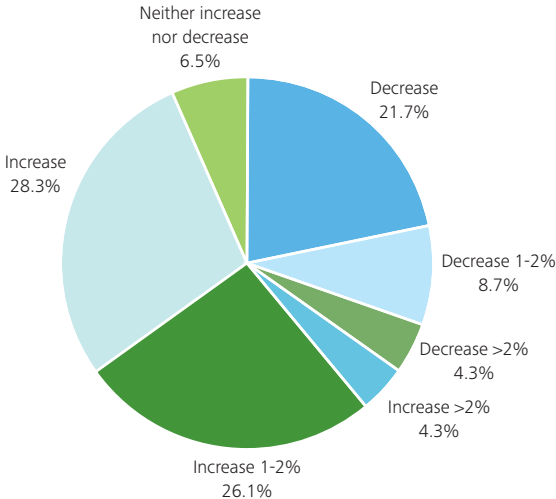
Deloitte’s annual event, “CFO Vision 2009: Standing Tall in Challenging Times,” took place September 23–25 in Washington DC. This year’s conference brought together over one hundred and twenty chief financial officers (CFOs) from across the country. Just prior to the meeting, 46 of these CFOs participated in a short survey on the future of capital, sharing their expectations about the cost, source and mix of capital for their companies, as well as their expectations for inflation. In addition, polling technologies used throughout the conference gathered further CFO concerns and expectations for the economic recovery and other top-of-mind issues. This paper provides a snapshot of the survey and select polling results highlighting CFO expectations for the future of capital.

Most CFOs Expect Their Cost of Capital to Increase

In the “Future of Capital” survey, the majority of respondents (58.7 percent) noted their weighted average cost of capital would increase in the next year. About a quarter of the respondents felt it would increase by one percent or less, another quarter felt it would increase 1–2 percent and 4.3 percent of respondents felt the cost of capital could increase 2 or more percent.

However, approximately 35 percent of respondents also felt their cost of capital would go down. This could occur if the companies are able to lower their higher interest debt by paying it down. The latter is consistent with another observation from the survey of continued deleveraging.

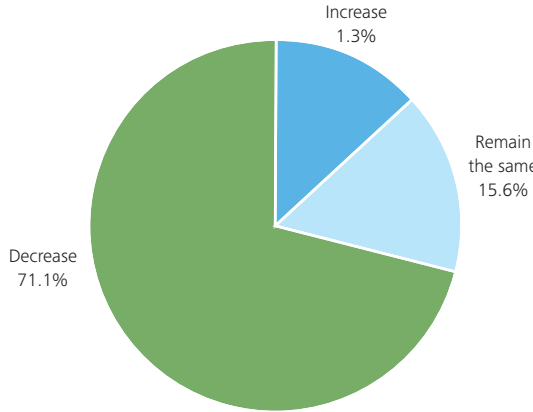
Figure 1. In the next year, your weighted average cost of capital will: (Based on 46 responses)



Deleveraging Continues

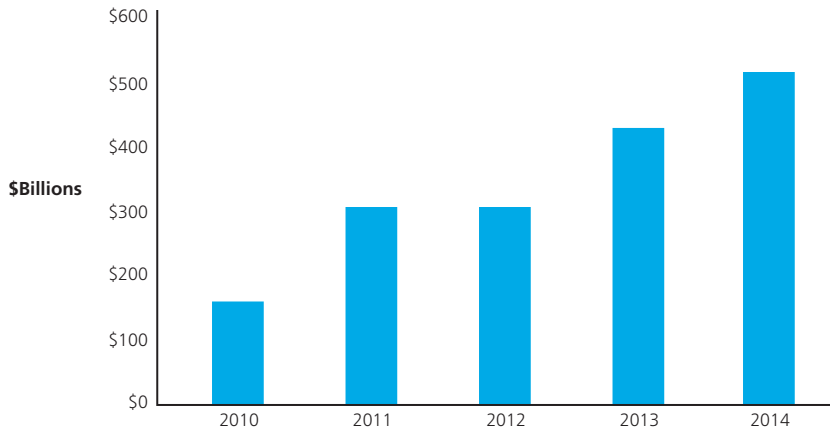
Seventy one percent of the respondents expect their debt to equity ratio to go down in the next year. Since many CFOs anticipate increasing interest rates or continued challenges in refinancing debt, it is not surprising that many companies are working to lower their debt and reduce the costs of debt service. We expect CFOs to continue deleveraging in the coming years.

Figure 2. One year from now, your debt to equity ratio will: (Based on 46 responses)



In an audience poll during a panel discussion on capital markets, many CFOs expect the cost of debt to remain high, and the spread between LIBOR and the actual interest the banks charge for loans to also remain high. CFOs also noted difficulties in arranging long term debt — especially beyond two to three years. With trillions of dollars in worldwide debt coming due from 2011 through 2014, CFOs need to secure and diversify sources of capital sooner rather than later, to avoid more intense competition for capital in the coming years (see Figure 3).

Figure 3. Estimated global debt maturities



Source: JP Morgan/Deutsche Bank Analyses

Figure 4. Which of the following do you currently use for short-term (working) capital?

(Based on 46 respondents)

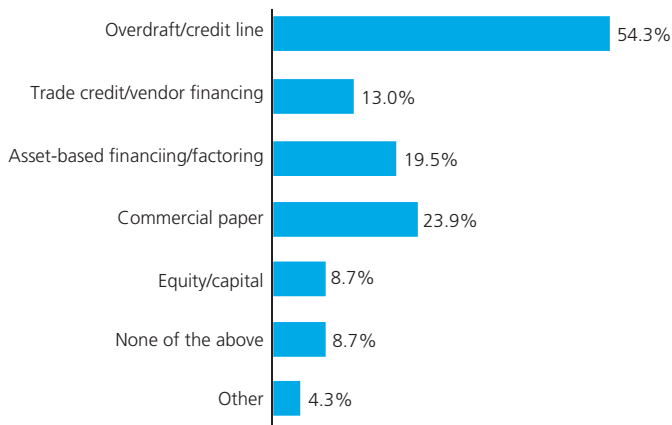
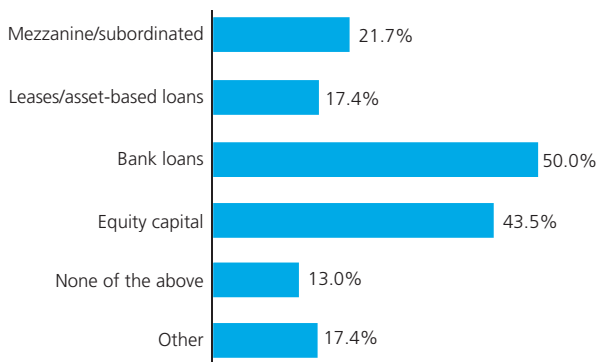


Figure 5. Which of the following do you currently use for long-term capital investment?

(Based on 46 respondents)



Sources of Capital Must Diversify

Currently, banks are the primary source of capital for both short and long term investments. Despite the end of “covenant light” loans and difficulties in securing loans, bank financing appears to be the source of choice for the coming year.

When asked about alternative sources of capital, five CFOs were looking to private equity, hedge funds and sovereign wealth funds as future sources. When the attendees were polled on their most preferred alternative source of capital, pension funds were the overwhelming choice over private equity, hedge funds, and sovereign wealth funds. Although not directly under their control, CFOs perceived that companies’ equity capital was minimally or not diversified. Given the changing financial landscape and continuing strains and failures in the banking sector, we expect CFOs, alongside the CEO and other stakeholders, to continue diversifying their sources of capital. Sources of debt capital were more diversified, and we expect this to remain so or to increase in the future.

Figure 6. How would you describe your sources of equity capital?

(Based on 44 respondents)

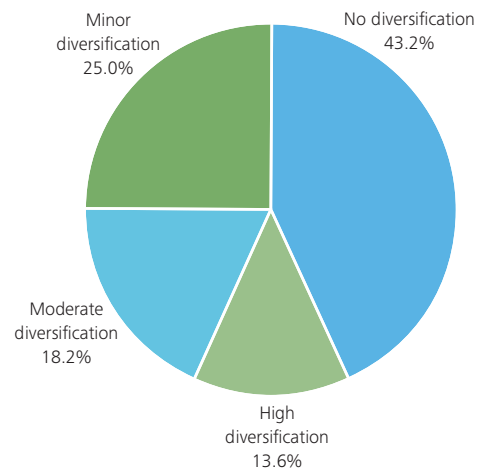


Figure 7. How would you describe your sources of debt?
(Based on 45 respondents)

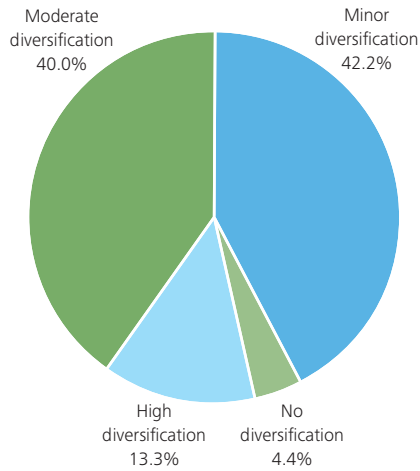
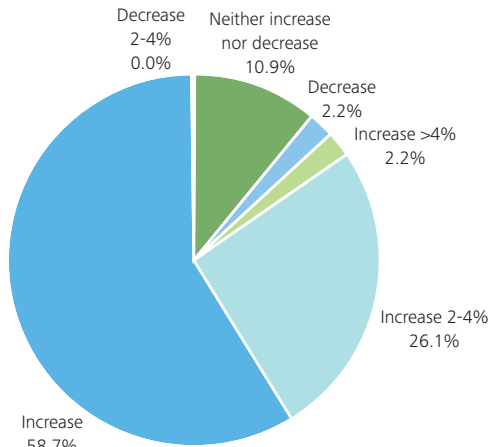


Figure 8. In the next year, inflation in the U.S. will:
(Based on 46 respondents)

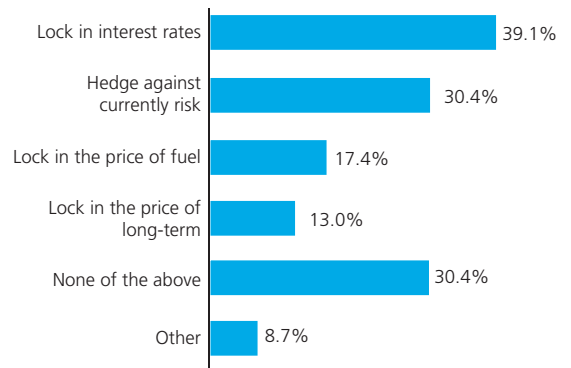


Recovering but Risky Roads Ahead

The good news overall was that most CFOs believe we are in a recovery. However, there is concern over the uncertainty about the shape of the recovery. Will it be a fast rebound, a double dip or even a Japanese-style slow recovery? Polling at our conference sessions found 57 percent of respondents believe in improved economic conditions for 2010. Thirty-three percent were most concerned by the shape of the recovery. Twenty-six percent were most concerned about planning and budgeting in uncertain market conditions, and 20 percent were most concerned with the possible return of inflation. Over 80 percent of our Future of Capital survey respondents felt inflation would increase in the coming year. Most felt it would increase between 0–2 percent. However, over a quarter of the respondents felt it would increase between 2–4 percent.

The survey findings suggest that CFOs are taking steps to manage capitalization, currency, inflation, and other risks. However, there is considerable opportunity to deploy risk management strategies.

Figure 9. Which of the following risk management strategies are you currently deploying? (Based on 46 responses)



Conclusions

CFOs continue to navigate uncertain waters and experience challenges with the sourcing and the cost of capital. We believe that, in addition to cost controls and liquidity optimization, CFOs will need to continue a sustained focus on diversifying sources of equity and debt capital, especially as competition for capital intensifies during the recovery, and companies seek to roll-over major tranches of debt in coming years. This would be the time to begin diversifying relationships and connect to pension funds, sovereign wealth, private equity or other sources as a complement to bank sources of capital.

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