Global Capital Confidence Barometer
China

Steady sailing ahead?

The China story

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 China subset of our findings gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their capital agendas.

Profile of respondents

- Panel of over 1,000 executives surveyed in July and August 2011.
- Companies from 51 countries.
- Cross-section of respondents from over 40 industry sectors.
- 63 respondents from China.
- Company revenues range from US$250 million to over US$10 billion.

The Capital Agenda
Based around four dimensions, it helps companies consider their issues and challenges and understand their options to make more informed capital decisions.

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 fifth bi-annual *Global Capital Confidence Barometer* finds that almost half of respondents are focused on growth in the next 12 months, with only 7% now focusing on survival – the lowest number since the barometer was first published in 2009.

There is a new paradigm with M&A activity and market volatility now able to co-exist. Currently, leading companies are shrugging off continued market upheaval and focusing on growth and M&A. For them, this is not 2008 all over again. They have spent the past three years reducing the financial risk on their balance sheet and taking tough efficiency measures needed to strengthen their positions, which helps them manage in volatile times.

Chinese executives, while reflecting much of the global sentiment, remain stoic as they focus on growth opportunities at home and abroad. China continues to benefit from the strength of the renminbi, which hit an all-time high against the dollar last month, and from the robust cash positions that many of its companies enjoy.

A debt-averse regulatory environment at home has helped shelter Chinese companies from the post-2008 credit crunch, limiting the volatility that has affected other companies in the global survey. In addition, the continued influx of foreign direct investment into the country continues to fuel broad interest in the domestic market, a fact that Chinese respondents highlight in several areas of the survey when they note increasing competition for assets.

To be sure, the survey contains some potentially confusing messages. Chinese respondents say they are less likely to pursue acquisitions over the next 12 months than those in the global survey, even though they expect to use excess cash for both organic and inorganic growth over the next year.

This apparent contradiction reflects the challenges that Chinese businesses are seeing, both at home and abroad. Uncertainty overseas is creating more buying opportunities but also raising more questions about valuation. Chinese companies pursuing outbound deals believe they are encountering more regulatory obstacles, particularly in North America, and are feeling greater scrutiny of outbound deals from the Chinese government, which is also keen to make sure they don't overpay for assets while at the same time supporting Chinese companies 'going global'.

Meanwhile, Chinese companies are facing new opportunities at home, albeit with some challenges. China's 12th five-year plan, launched earlier this year, has streamlined industrial policy by emphasizing seven sectors that the government intends to support in the future, a policy shift that is likely to lead to both consolidation and further buying opportunities domestically.

Bob Partridge – Greater China Leader, Transaction Advisory Services

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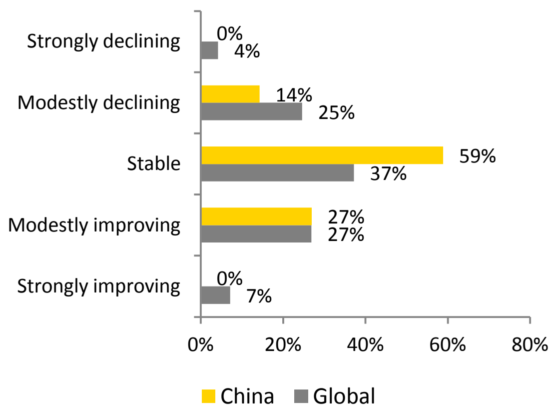
Economic outlook

Chinese investors remain stoic about global economy

Chinese survey respondents, like their global peers, appear to be relatively hopeful in October about increasing global economic volatility. A majority (65%) say the global economy is stable or modestly improving, with a significantly larger percentage (46%) seeing stability, compared with the global sample (37%).

Chinese respondents are, perhaps unsurprisingly, even more bullish about the outlook for their local economy, with 86% viewing local conditions as stable or modestly improving, compared with 71% of global respondents who feel the same.

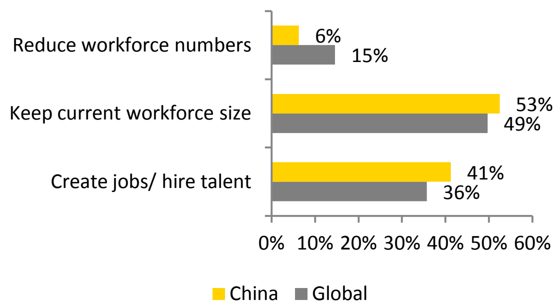
What is your perspective on the state of the local economy today?



Bullish on employment

Chinese survey respondents are also more optimistic about the employment outlook over the next year, with 41% expecting to add to their workforce, compared with 36% of the global sample, and just 6% envisioning job cuts, significantly less than the 15% of global respondents who expect to reduce their corporate head count.

With regards to employment, which of the following does your organization expect to do in the next 12 months?



Regulatory concerns

Chinese companies share their global counterparts' concerns about the impact regulation poses to growth and profitability over the next 12 months, with both groups listing banking, tax and environmental regulations as their top three concerns.

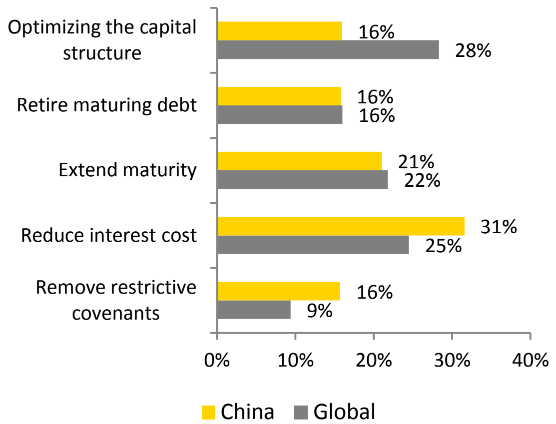
86% of Chinese respondents view local conditions as stable or modestly improving

Access to capital

Few companies need to refinance

Although the global economic outlook is clearly gloomier than was the case last year, the financial position of Chinese companies remains comfortable in October 2011, with just 30% saying they need to refinance loans or other debt obligations over the next twelve months, similar to the 29% of the global sample that answered accordingly. And, while global companies refinancing debt over the next year are largely looking to optimize their capital structures, Chinese companies are more likely to be motivated by the desire to reduce their interest costs.

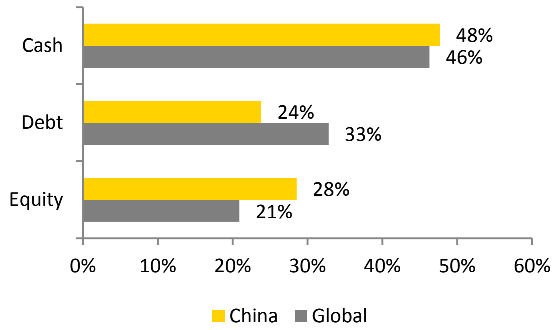
What will be the primary purpose of your refinancing?



31% of Chinese companies are more likely to be motivated by the desire to reduce their interest costs

Meanwhile, while nearly half of Chinese and global survey respondents say cash will be the primary funding source for deals over the next year, the remainder of Chinese respondents were more likely to fund deals with equity than debt, where the reverse is true among the global sampling.

What is your primary source of deal financing in the next 12 months?



Not surprisingly, given the debt averse Chinese corporate culture, 93% of Chinese respondents expect debt to account for no more than 30% of their acquisition funding in the next 12 months; 13% of respondents don't plan to use debt at all. By contrast, a quarter of global respondents expect debt financing to make up 50% or more of their acquisition funding in the next year.

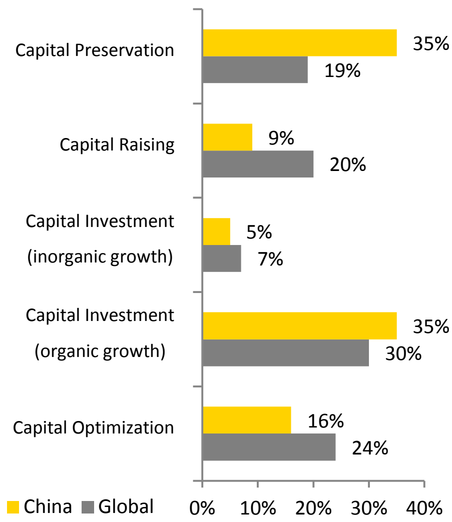
Similarly, Chinese respondents were much less likely to consider employing the excess working capital of an acquisition as a source of deal funding, with just 26% of them saying they would do so, compared with 47% of the global sample.

Growth

Capital preservation and investment remain priorities

Chinese companies cited capital preservation and investment as their main priorities within the capital agenda. Equal percentages of Chinese respondents (35%) cited capital preservation and organic growth as their main priorities, compared with 19% and 30%, respectively, in the case of global respondents.

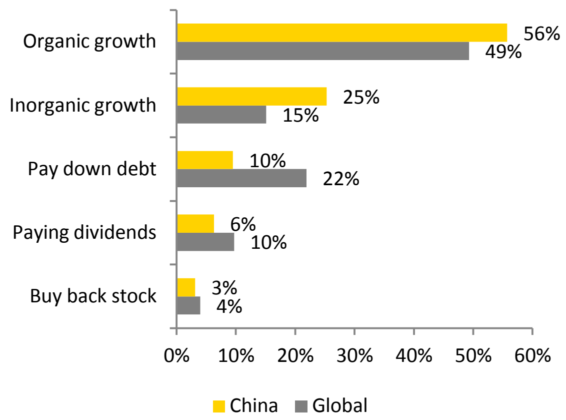
On which of the following capital management issues is your company placing the greatest attention and resources today?



While 20% of global companies said they were devoting the greatest attention and resources to capital raising, just 9% of Chinese companies said they same. The lower priority given to raising funds by Chinese respondents may be a result, in part, of the softening market for initial public offerings, which have previously been an important source of capital for Chinese companies. In the third quarter of 2011, in particular, there has been a decrease in the opportunities for Chinese companies to tap IPO markets in Hong Kong and the mainland, with the result that many are looking to minority investors and JVs as alternative sources of capital.

For those Chinese companies that do have excess cash, more than three quarters intend to use it to grow their companies over the next twelve months, with 56% opting for organic growth and 25% looking to make acquisitions, compared with just 15% of global companies that plan to use cash for acquisitions.

If you have excess cash, which of the following will be your priority over the next 12 months?



The China story: Chinese companies cited capital preservation and investment as their main priorities within the capital agenda.

On which of the following capital management issues is your company placing the greatest attention and resources *today*?

35%
of China respondents say they are focused on **preserving** capital

16%
of China respondents are focused on **optimizing** capital

40%
of China respondents say they are focused on **investing** capital

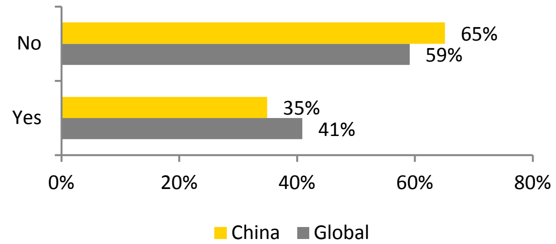
9%
of China respondents are focused on **raising** capital

Mergers and acquisitions outlook

Companies have resources for deals, but remain cautious

While Chinese companies say they are likely to use any spare cash to grow their companies, only a minority, 35%, actually expect to pursue acquisitions in the next twelve months, slightly lower than the 41% of global firms that expect to do so. Although the global figure is unchanged from October 2010, 51% of Chinese companies surveyed a year ago expected to make acquisitions within twelve months.

Does your company expect to make acquisitions in the next 12 months?



For those Chinese companies actively looking to make acquisitions, a resounding 81% say they are most likely to invest in the Asia Pacific region, followed by 33% who named Western Europe and 24% who mentioned North America[1]. By comparison, just half of global investors say they are most likely to invest in Asia Pacific, with 28% preferring North America and a nearly equivalent 27% favoring Western Europe.

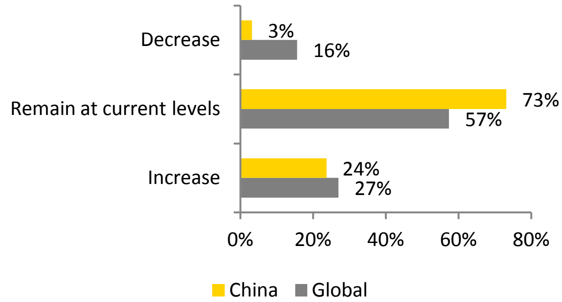
Chinese respondents are primarily interested in acquisitions as a way of increasing their presence in existing markets, compared with their global counterparts, a plurality of whom are looking to expand into new markets.

[1] Respondents were asked to identify the top 5 countries they are likely to invest in.

Valuation levels remain a cause for concern

While a majority of both Chinese and global respondents expect little change in asset prices and valuations over the next 12 months, only 3% of Chinese companies expect valuations to decrease over that time, compared with 16% of the global sample, perhaps reflecting a belief among Chinese companies that competition for assets remains strong enough to underpin higher valuations.

What do you expect the price/valuation of assets to do over the next 12 months?



Indeed, just 3% of Chinese executives believe competition for assets has decreased over the past six months, compared with 12% of global respondents. This in all likelihood reflects that the M&A environment at home in China continues to be robust.

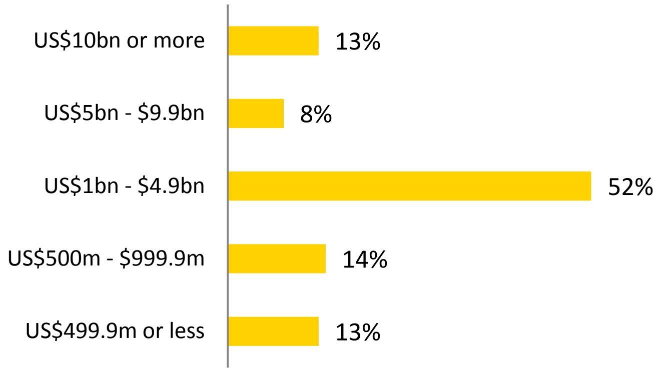
Greater scrutiny from government agencies is clearly causing Chinese investors to worry more than their global peers about overpaying for deals. Asked about the most significant issues contributing to deals not meeting expectations, 28% of Chinese respondents and 20% of global respondents mentioned overestimation of strategic value or excessively high purchase price multiples.

Few expecting divestments

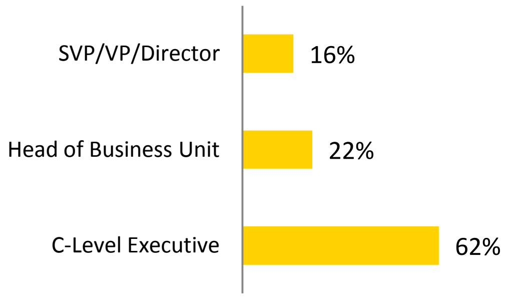
More than three-quarters of both Chinese and global respondents says they see little likelihood of making divestments in the next year. Chinese respondents were most likely to cite the need to shed an underperforming business unit as the main reason for making a divestment.

Survey demographics (China)

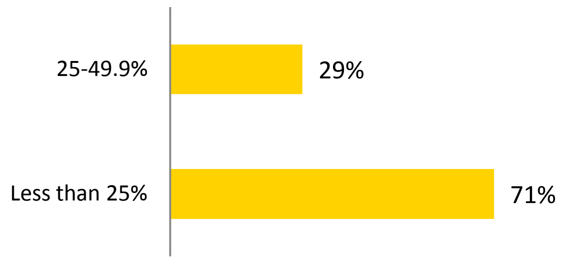
What are your company's annual global revenues in US dollars?



What is your position in the organization?



What is your current debt to capital ratio?



Participants were representatives from the automotive, consumer products, financial services, manufacturing, mining and metals, oil and gas and power and utilities industries.

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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*The Ernst & Young 1,000 is a panel Ernst & Young clients and contacts and Economist Intelligence Unit contributors who participate in the Capital Confidence Barometer on a biannual basis.

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