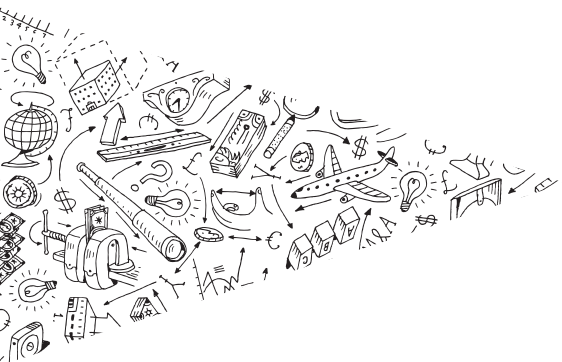


# Capital Confidence Barometer



## Full steam 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).

### Profile of respondents

- ▶ Panel of over 1,000 executives surveyed in September 2010
- ▶ 62 respondents from China
- ▶ 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



**Bob Partridge**  
Greater China Leader



**Lin Cai**  
China North Leader



**Tony Tsang**  
China Central Leader

We are delighted to introduce you to the *Capital Confidence Barometer*, a unique ongoing study that measures corporate confidence in a changing market.

This survey of executives from some of the largest global companies finds market conditions improving but suggests that broader concerns about the sustainability of the global economic recovery are making organizations more wary, a sentiment that is likely to curtail global M&A volumes for at least the next six months.

Chinese executives, while reflecting much of the caution about broader economic trends, are more optimistic about prospects for their companies and the local economy. Like their global counterparts, most expect the wider economic downturn to persist for more than 12 months.

Chinese executives, in line with their global peers, are confident of their ability to act opportunistically and also continue to enjoy abundant liquidity, so it is hardly surprising that they are broadly optimistic about credit conditions, similar to the results of the global survey. Half of Chinese respondents say they are in a position to act quickly to compete for targets at short notice, the same percentage of global executives who report being well-positioned. Just 15% say they are poorly positioned to act on such chances, slightly higher than the 11% of global respondents who describe themselves as similarly constrained.

Chinese companies retain strong cash positions, and they continue to focus on making their businesses more cost efficient and allocating capital to organic growth and investment in research and development. M&A has been sidelined to a greater degree, as evidenced by the rankings on capital allocation, in which Chinese executives list M&A as their third priority.

Still, as has been the case with other emerging market countries, the Chinese have a stronger appetite for transactions than their global counterparts, with just under a third of respondents saying they intend to seek growth opportunities in the M&A market in the next half year.

Indeed, with new Chinese government data showing that the country was the fifth largest global outbound investor in 2009, up seven places from a year earlier according to the Ministry of Commerce, it's clear that Chinese companies are unwilling to rule out opportunities to grow through strategic transactions.

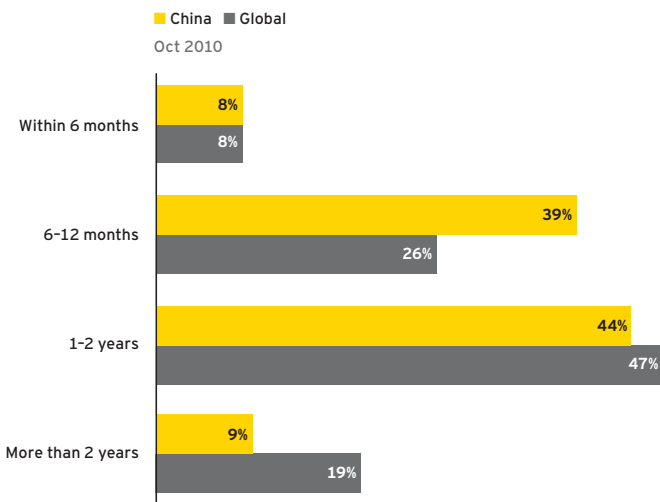
## Key highlights

### Economic outlook

Sentiment about the broader economy remains more guarded. The Chinese are more cautious about the global economic recovery than they were in April, but are more optimistic overall than their global counterparts. Just under half of Chinese, 47%, say the downturn will be over within 12 months, while global respondents are even more bearish, with just 34% expecting the downturn to finish within the year; an even smaller percentage of US executives (28%) agree with this timeline.

However, Chinese are bullish about prospects for the local economy. The Chinese are more confident about their local economy than the global sample, in common with the majority of the BRIC (Brazil, Russia, India, China) markets. Eighty-two percent of Chinese say they are more optimistic about their local economy. In India, 92% describe themselves as confident about the next year, while 89% of Russians feel the same. Meanwhile, Brazilians are more muted, with 69% saying they feel more optimistic about the next 12 months, similar to the 67% who say so worldwide.

### How long does your organization expect the financial crisis and resultant downturn to persist in the broader economy?



**82%** of Chinese respondents say they are more optimistic about their local economy.

### Capital markets

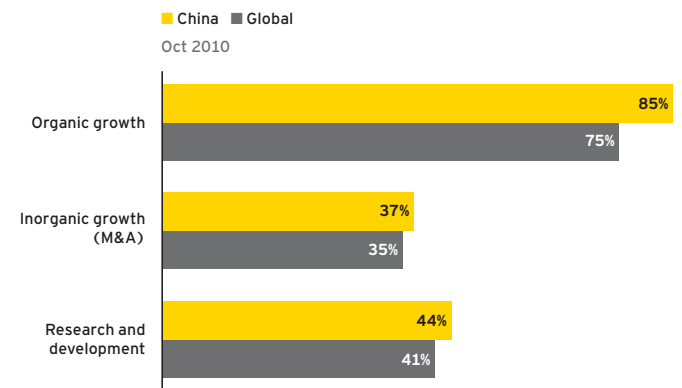
The Chinese see more improvement in credit and capital conditions than the global average, but are less convinced about having immediate access to capital.

Seventy-one percent of Chinese executives say credit and capital conditions have improved in the past six months, higher than the 58% of global respondents who report improving conditions over the past six months and the 47% of US executives who are similarly optimistic.

Chinese sentiment about credit conditions is in line with that of fellow BRIC countries India and Russia, and higher than the 62% of Brazilians who reported improved conditions.

Like their global counterparts, Chinese have downgraded M&A in favor of organic growth and research and development in their capital allocation priorities. Both Chinese and global respondents cite organic growth and research and development as their top two priorities for capital allocation in October, with M&A coming third in both groups.

### Where is your organization currently prioritizing capital allocation? Top 3



## Mergers and acquisitions outlook

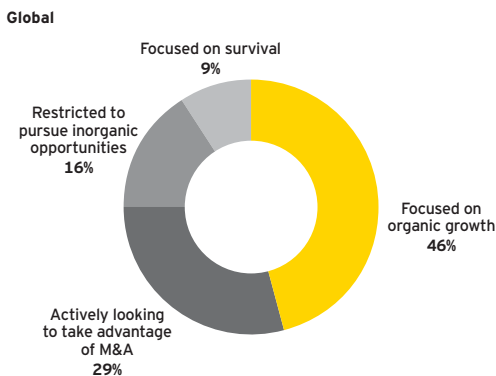
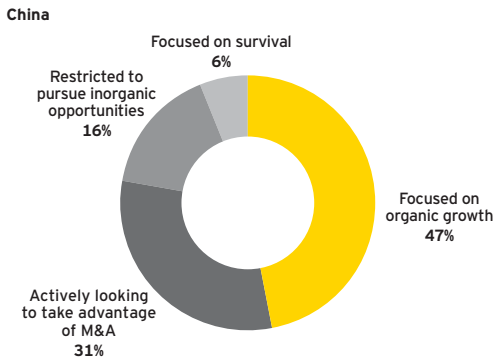
Chinese appetite for mergers and acquisitions is slightly higher than that of the global survey even though Chinese respondents, like their global counterparts, are making organic growth their company's focus for the near term.

Thirty-one percent of Chinese say they are actively looking to take advantage of M&A opportunities for growth over the next six months. In comparison, 29% from the global survey expect to take advantage of M&A opportunities within that time period.

Chinese enthusiasm for M&A over the next six months is also stronger than that in the US (26%) and is the highest of the BRIC nations: In India, 27% are actively looking to grow through M&A in the next six months, compared with 23% in Russia and just 18% in Brazil.

The Chinese may be more bullish about M&A because they are less concerned about their immediate future: the number of Chinese companies who say they are focusing on survival over the next six months is just 6%; by contrast, 9% of global executives said they remain focused on survival.

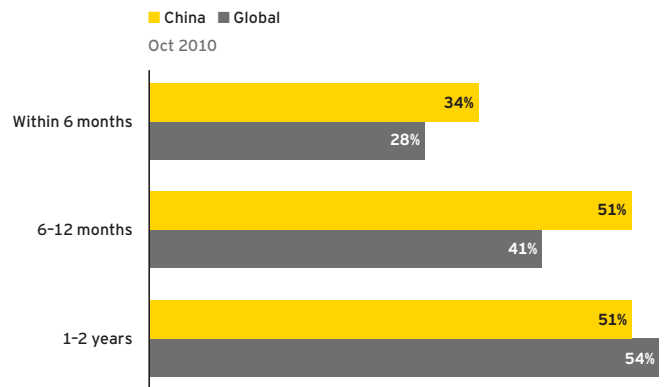
### Which statement best describes your organization's focus over the next six months?



Further out on the timeline, the Chinese are even more upbeat about acquisitions. Fifty-one percent say they are likely or highly likely to make an acquisition in the next 12 months.

By comparison, 41% of global executives and 42% of US executives described themselves as likely or highly likely to acquire an asset within the next twelve months. Meanwhile, China's BRIC peers are also more doubtful: 44% of Indian executives, 43% of Brazilian executives, and just 27% of Russians expect to make acquisitions within the next year.

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



Meanwhile, joint ventures and alliances remain one of the most popular ways by far for Chinese companies to grow inorganically. A majority of those surveyed in October, 52%, say they are likely or highly likely to entertain a JV or alliance within the next six months, exceeding both the 40% of US and 33% of global executives who anticipate entering a JV or alliance during the same time period.

Among the BRIC markets, only Russians are modestly more likely to consider such an arrangement within the next six months, with 57% answering in the affirmative. By contrast, a third of Indians, similar to the global average, and only 31% of Brazilians have a JV or alliance in their sights.

**34%** of Chinese executives expect to take advantage of M&A opportunities in the next 6 months.

# Preserving

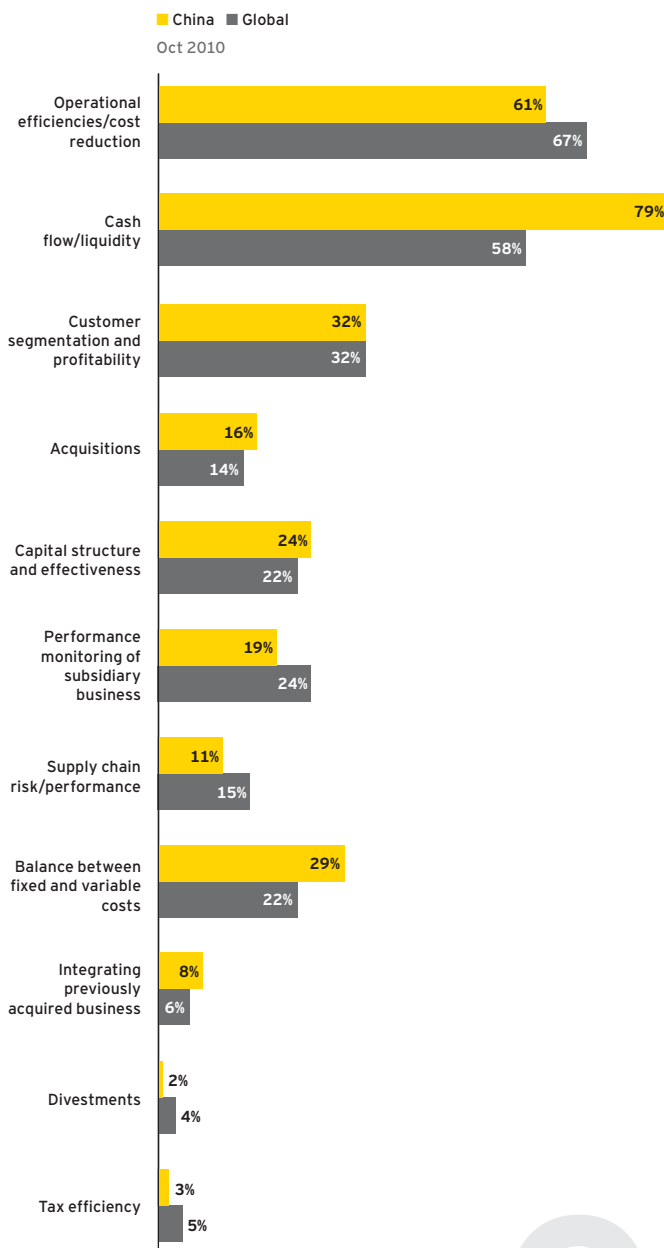
## Results

### Preserving capital

Chinese respondents expect to narrow their focus on their cash position over the next 12 months. The bulk of executives, 79%, say they will concentrate on cash flow liquidity over the next year, with 61% saying operational and cost efficiencies will receive increased attention.

Among the global survey, these priorities are reversed, with 67% saying they will pay most attention to operational and cost efficiencies, and 58% highlighting cash flow/liquidity issues, a ranking that is broadly reflected in the US survey.

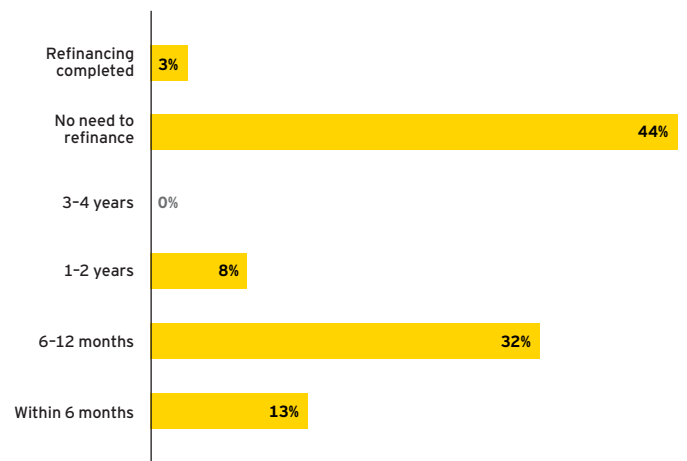
### Which of the following aspects of your business do you expect will receive increased attention over the next 12 months as a results of the economic situation?



Chinese executives remain comfortable with their debt positions, reflecting improving sentiment about credit conditions worldwide. Nearly half of those surveyed, 44%, say they have no need to refinance debt obligations, and just 13% expect to refinance within six months.

Among global executives, 52% have no need to refinance while 11% expect to refinance within 6 months.

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



Reflecting their stated intention to focus on organic growth, the largest number of Chinese executives, 40% say their greatest priority is their core business, an identical number to the global survey.

Chinese views of the health of their businesses are more upbeat than those of executives from two of the other BRIC countries: in India, 54% of those surveyed expect to restructure a core business, while 62% of Russians say they are likely to do so. Only in Brazil does a lower percentage, 20% see restructuring a core business as their greatest need.

## Optimizing Capital

Chinese companies are continuing to evaluate their operational health, with organic growth and cash-flow issues likely to preoccupy management over the next year.

### The top five areas of focus for organizations for the next 12 months are:

#### China

1. Organic growth through investment in existing businesses
2. Cost efficiencies across existing assets
3. Growth through acquisitions, partnerships or JVs
4. Operational synergies within the portfolio
5. Capital generation through asset sales

#### Global

1. Organic growth through investment in existing businesses
2. Cost efficiencies across existing assets
3. Operational synergies within the portfolio
4. Growth through acquisitions, partnerships and JVs
5. Increasing portfolio flexibility to react to change

## Raising Capital

Chinese companies are more cautious about the timeline for funding new transactions and/or capital projects, in line with their global counterparts, although the picture remains somewhat mixed.

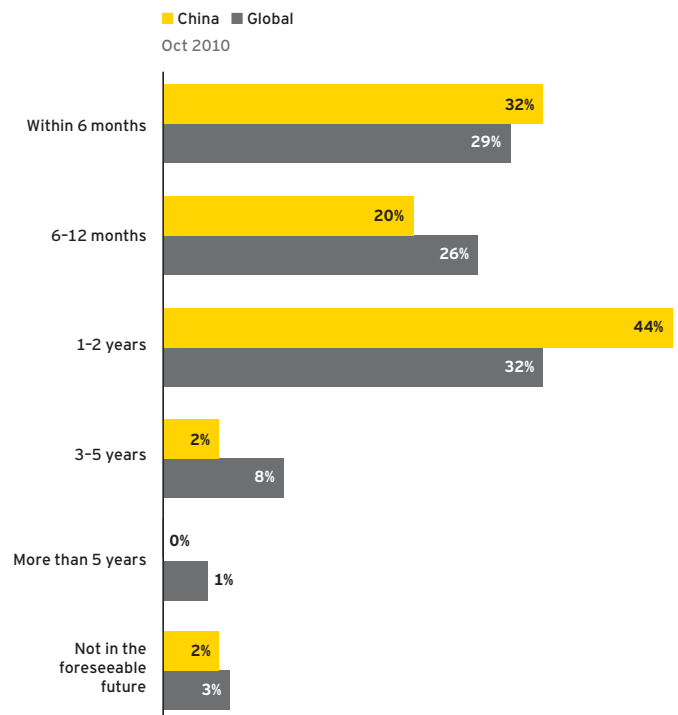
While 32% of Chinese executives surveyed in October see funding available within six months, 44% now expect to wait 1 to 2 years to finance significant transactions.

Among global respondents, a similar pattern is evident, with 29% expecting to fund acquisitions and other projects within six months, and 32% expecting those transactions to wait 1 to 2 years.

Likewise, in BRIC neighbor India, 33% of executives expect to get financing within six months, while respondents from the other two countries in the group were even less optimistic: in Russia, just 22% thought financing would be available to fund transactions and projects within six months while in Brazil the figure is 23%.

In the US, just 14% anticipate financing large capital projects within six months, but an additional 46% report no problems getting access to capital at all.

### When do you expect financing to be available to fund major acquisitions and/or capital projects for your organization?



Chinese companies have traditionally used cash to finance transactions and they remain focused on cash as their preferred form of deal financing; the global survey has now fallen in line with this preference. BRIC countries also favor cash over other forms of financing, with the exception of India, where similar percentages of respondents say they are likely to use cash, debt, shares and bank loans as to fund deals.

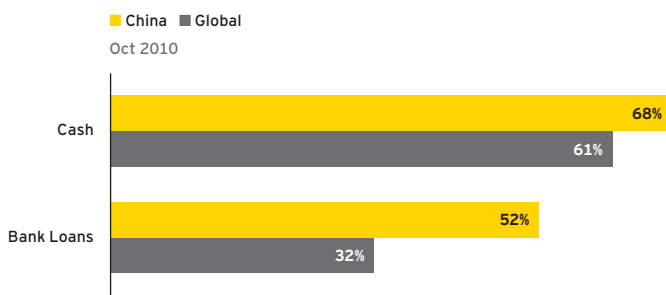
Sixty-eight percent of Chinese respondents are planning to use cash to fund deals over the next 12 months with 52% opting for bank loans.

Global respondents' preferences are virtually identical in each category, while US executives have an even more decisive preference for cash (69%) over bank loans (30%).

Among the BRICs, Brazil and Russia reflect the global trends, with 57% and 75%, respectively, preferring cash. While Indian executives also rank cash as their financing of choice for the year going forward, the percentage (45%) is noticeably more muted.

**68%** of Chinese respondents are planning to use cash to fund deals.

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



**Companies less likely to divest in the short-term:** Chinese investors continue to be reticent about divestments, preferring to sell assets via joint ventures in which they continue to hold an interest. In contrast to their global peers, Chinese companies selling assets outright tend to do so to related parties.

Executives from other BRIC countries have a more diverse view on asset sales: a similarly paltry number of Russians, 8%, envision divestments over the next six months, compared with 12% of Indians and a notable 25% of Brazilians.

By contrast, 15% of global respondents say they are prepared to make divestments in this period.

### Investing capital

While Chinese executives are focused, like their global counterparts, on organic growth, they remain more willing than many to take advantage of M&A opportunities within the next year.

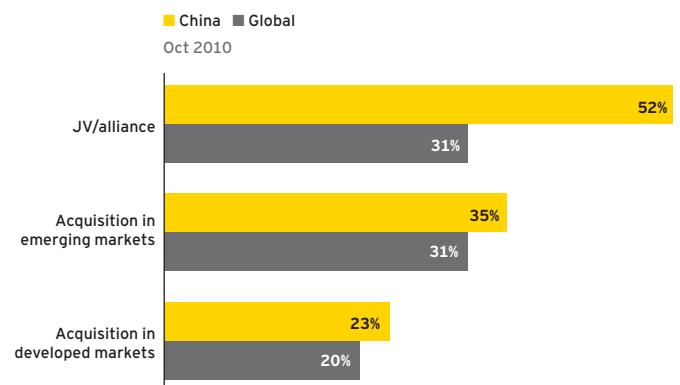
When presented with the prospect of making an acquisition at short-notice, half of Chinese and global executives say they are financially and strategically well-positioned to act quickly, slightly higher than the 45% of US respondents who put themselves in the same category.

Only Russian executives claim to be in a more enthusiastic M&A position among the BRIC group, with 72% saying they are well-positioned to take advantage of transaction opportunities, compared with just 39% of Indians and Brazilians.

In a further sign that companies are feeling the pressure to do deals again, roughly a quarter of the Chinese and global executives say that while they are not well positioned to act quickly, they would still pursue the opportunity.

Outbound transactions are a growing force in the Chinese M&A landscape and this is reflected in some of the survey results, which suggest Chinese companies are increasingly competitive with more established international companies. Thirty-five percent of Chinese companies expect to make emerging market acquisitions in the next six months, compared to 31% of global companies. Meanwhile, 23% of Chinese executives anticipate developed-market acquisitions, similar to 20% of global respondents.

### Which of the following are you likely to undertake or seriously consider in the next six months?



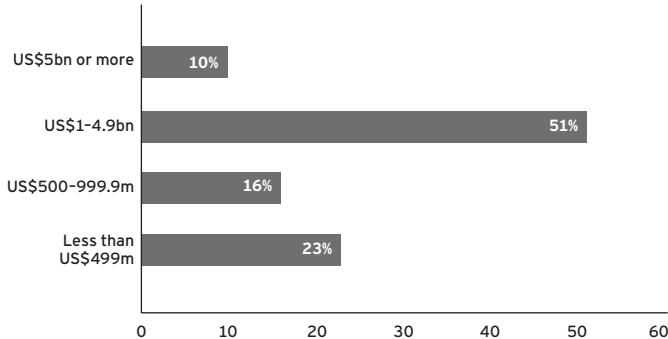
Like their global counterparts, Chinese executives identify revenue growth as the top value driver for valuation. Seventy-six percent of Chinese say this is the most important driver, identical to the percentage of global executives who cite it as the key value driver.

# Conclusion

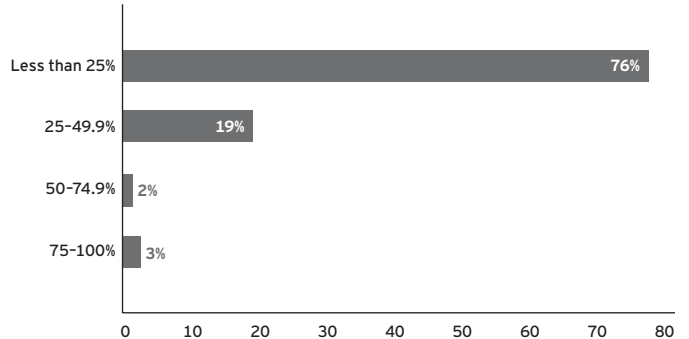
- ▶ Chinese executives' optimism about their local economies continues to be strong, with Chinese respondents slightly more bullish than their global counterparts.
- ▶ However, the Chinese are more guarded about predicting a quick end to the global economic downturn.
- ▶ Chinese companies are positive about overall credit conditions, and they agree that organic growth and research and development will remain priorities for capital allocation in the near future. Although they have downgraded the importance of M&A, a significant percentage of Chinese companies will be on the lookout for opportunities in the near term, where viable.
- ▶ Cash-flow liquidity and operational efficiencies are likely to get the most attention from Chinese executives over the next six months as companies look to flex their capital structures to the best of their abilities.
- ▶ Companies remain generally reticent about both acquisitions and divestments in the short-term, but they remain enthusiastic about partnerships, with a majority expecting to enter new joint ventures or alliances within the next six months.

## Survey demographics (China)

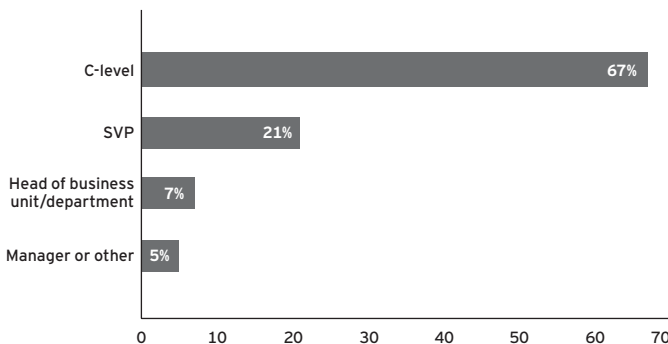
What are your company's annual global revenues in US\$?



What is your current debt to capital ratio?



What is your position in the organization?



Participants were representatives of the automotive, manufacturing, oil and gas and power and utilities industries.

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