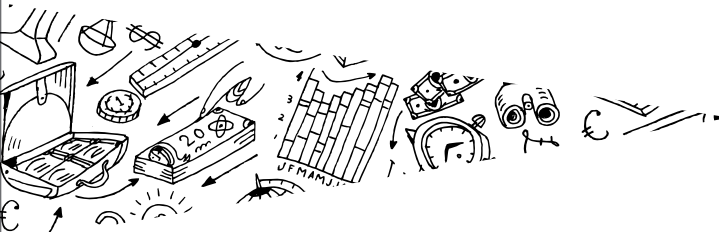


Capital Confidence Barometer



About this survey

Ernst & Young's *Capital Confidence Barometer* is a regular survey of over 1000 senior executives from large organizations around the world, conducted by the Economist Intelligence Unit (EIU).

This snapshot of our findings gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their capital agenda.

There were 86 respondents from India, the fourth-highest response rate from a country in the survey.

Profile of respondents

- ▶ Cross-section of respondents from around 15 industry sectors
- ▶ More than 80% of the respondents comprising C-level executives and heads of business units
- ▶ Around 80% respondents from companies with revenues exceeding US\$500 million per annum

The Capital Agenda

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

1. **Preserving capital:** reshaping the operational and capital base
2. **Optimizing capital:** driving cash and working capital, and managing portfolio of assets
3. **Raising capital:** assessing future capital requirements and evaluating funding sources
4. **Investing capital:** strengthening appraisal of investments and execution of transactions

Trend towards organic growth continues; M&A appetite also on the rise



The fifth edition of the Capital Confidence Barometer tells us that whereas organic growth continues to attract the attention of businesses, there is also a renewed interest among companies to grow through the inorganic route, including M&A. Confidence in credit conditions and capital markets has, however, declined due to continuing volatility.

Globally, respondents are of the opinion that the state of the global economy is either stable or is improving, despite tremendous uncertainty. In India, respondents are even more upbeat about the prospects of the domestic economy and their respective businesses.

Insights from our C-level respondents indicate that most organizations continue to emphasize on exploring organic growth options. Their confidence in the opportunities presented by the booming domestic economy is encouraging them to actively pursue the organic growth route. Their desire to improve their market shares and boost their revenues is driving their investment plans. Therefore, they are continuing to focus on pursuing organic growth and increasing their appetite to grow inorganically through M&A, and are looking for acquisition targets to gain access to new markets and increase their share in existing ones. Over the next 12 months, their focus is to exploit growth opportunities to the maximum. The companies surveyed by us also indicated that increased regulatory pressures and valuation uncertainties are likely to be some of their concern areas in the coming year.

This edition of the Capital confidence barometer underlines the fact that effective capital management is indispensable for the success and survival of organizations. The study gives us an indication of what C-suite executives feel about the country's economic outlook over the next 12 months and how they plan to deploy their capital to maximize their returns and achieve their goals during this period.

Ranjan Biswas

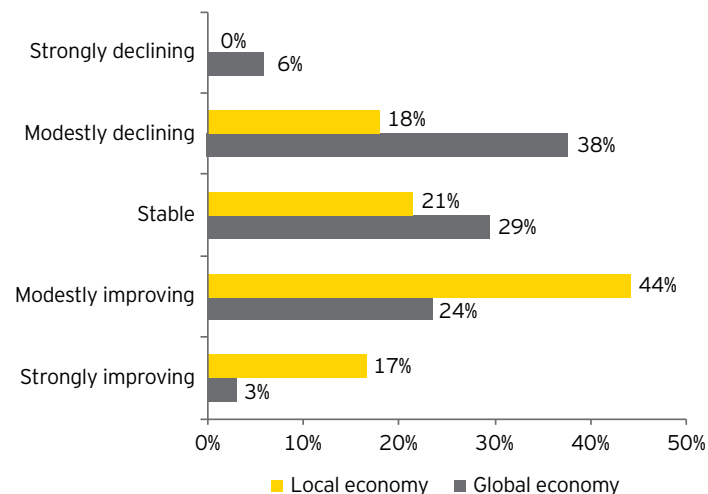
Partner and National Director
Transaction Advisory Services
Ernst & Young Pvt. Ltd.

Economic outlook

The Euro zone debt crisis, US credit rating downgrade, weakening economic data from around the world and ensuing fears of a double-dip recession have sparked off dramatic stock market volatility and fluctuations in currencies and commodity prices in the past few months. However, despite ongoing uncertainty, according to our global capital confidence barometer survey, 62% of global respondents feel that the state of the global economy is either stable or is improving.

Indian respondents share the opinion of their global counterparts about the global economy, with 56% of them being of the opinion that the global economy is either stable or is improving. Furthermore, they are largely positive about the prospects of the Indian economy, since around 61% of them feel that it is improving.

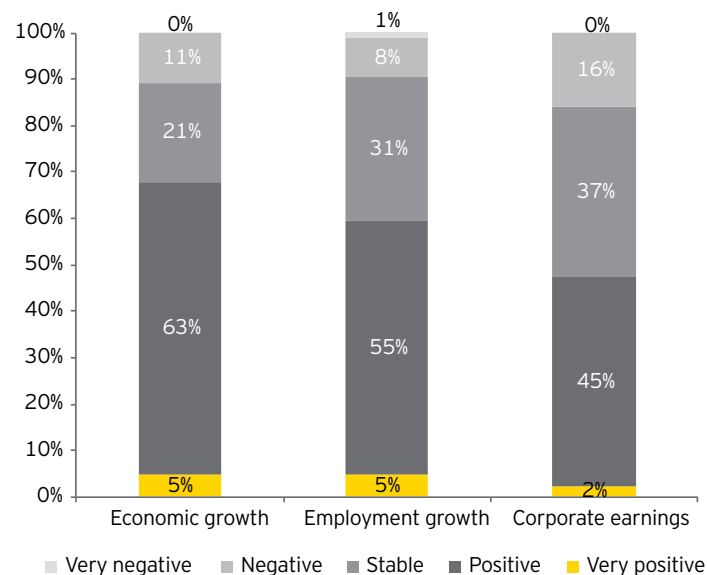
What is your perspective of the state of the economy today?



The optimism shown by Indian respondents is reiterated in their outlook on economic and employment growth, and corporate earnings. Around 68% of them expect economic growth to be positive or very positive and 60% feel that employment growth is likely to be positive or very positive. Their view of the domestic economy is largely based on prospects for their businesses, and 47% of them are positive or very positive about their corporate earnings.

However, the outlook for the domestic economy is clouded by spiraling inflation in the country and the consequent monetary tightening resorted to by the Reserve Bank of India (RBI), as well as the continuing volatility of the stock market.

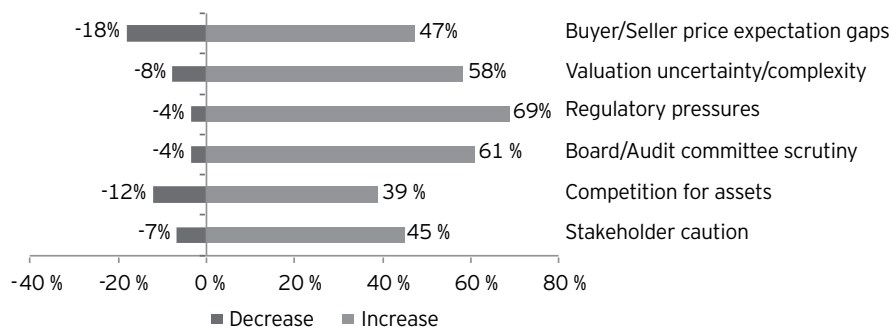
Please indicate your level of confidence in the following at the local level



Among the respondents, 69% feel that regulatory pressures have increased over the last six months, which may impact growth. Uncertainty and complexity in valuations and buyer-seller price expectation gaps are some of their other key areas of concern.

Around 61% of the respondents believe that scrutiny by boards and audit committees has intensified, which indicates an increased focus on good corporate governance practices.

In your view, which of the following have increased or decreased over the last six months?



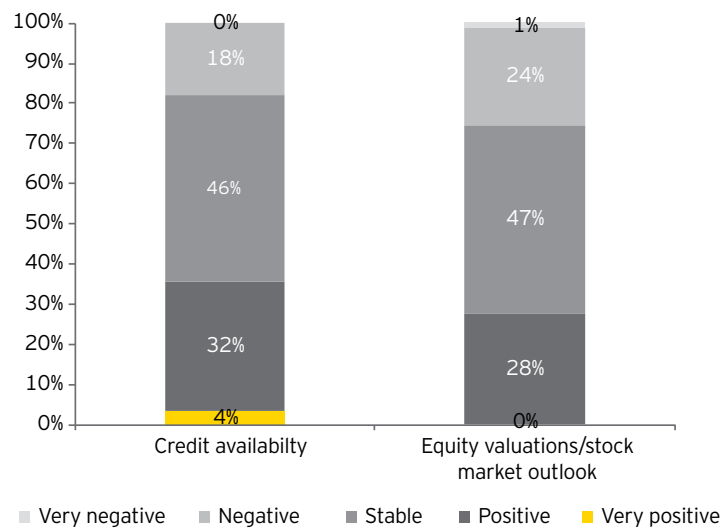
▶ Capital agenda

▶ Raising capital

Volatile credit conditions; uncertain stock markets

The RBI has raised its key interest rates 12 times since March 2010, which has increased the cost of debt significantly for companies. This has dented their credit availability confidence. Around 36% of the respondents believe that the credit availability outlook is favorable currently, as compared to 50% six months ago. However, with continuing volatility in stock markets during the last few quarters, the stock market outlook is at best stable.

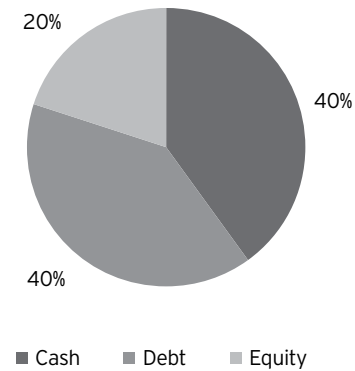
Please indicate your level of confidence in the following at the local level



Cash continues to be the primary source for funding deals.

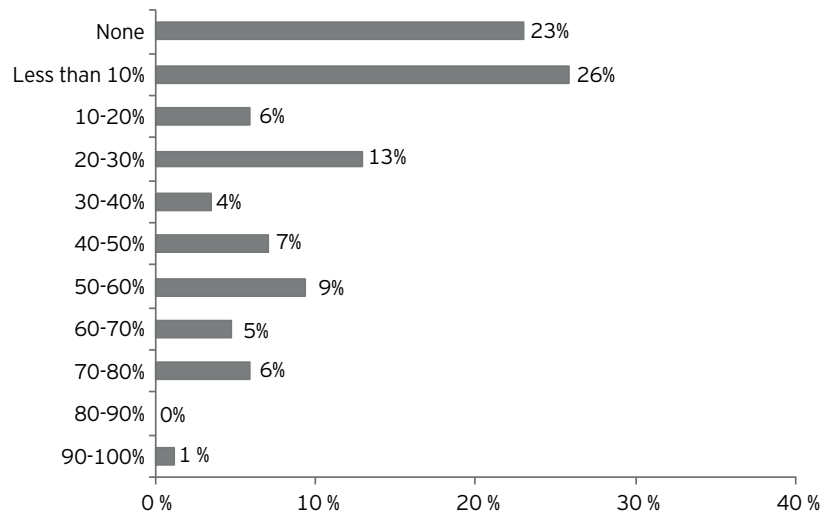
Cash is expected to be the preferred mode of funding deals in India during the next 12 months. Surprisingly, despite increasing interest rates in India, debt has also emerged as an attractive financing option. However, equity is not favored by respondents for funding transactions because of frequent stock market corrections and a lack of consensus on the movement of the market.

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



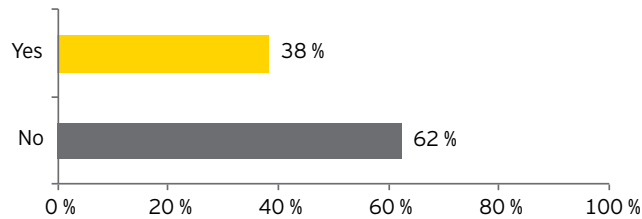
For deals planned in the next 12 months, around 23% of the respondents do not plan to use debt to fund acquisitions, while 26% aim to do so to finance 10% or less of the deal value. This indicates that companies are averse to increasing their debt in a rising interest rate environment.

What percentage of your acquisition funding will be in the form of debt during the next 12 months?

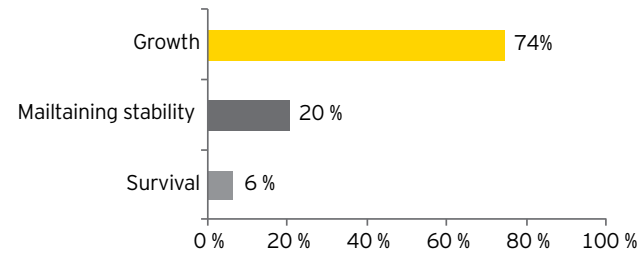


While exploring sources for funding transactions, around 38% of the respondents indicated that they viewed excess working capital of an acquired company as an option to fund deals.

Do you view the excess working capital of an acquired company as a source of deal funding?



Which of the following best describes your organization's focus over the next 12 months?



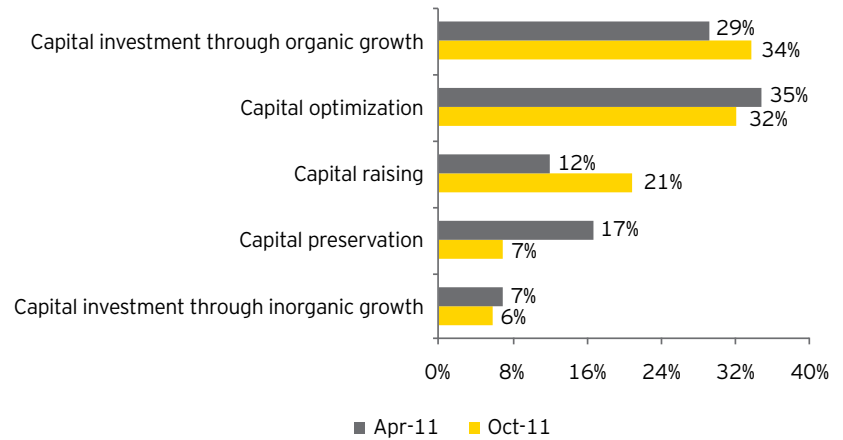
The importance of growing through the organic route is on the rise, with 34% of the respondents indicating that capital investment through organic growth (investment in products, research and development, and human resources) is their priority area, as compared to 29% six months ago. Capital optimization, e.g., improving working capital, releasing cash and optimizing the tax structure, is another area on which companies are increasing their focus, with 32% of them opting for this route.

▶ Investing capital

Organic growth continuing to be primary focus with increased emphasis on stability

Around 74% of the respondents from India have specified growth to be their focus area for the next 12 months. This is much higher, as compared to their global counterparts, with only 49% citing growth as their top priority. However, over the past few months, there is enhanced consciousness among Indian respondents on the need to maintain their stability. A possible reason for this could be the downward pressure on their margins due to increased commodity prices, employee costs and interest payments, which is leaving less on the table for exploration of investment opportunities.

On which of the following capital management issues is your company focusing its attention and resources?

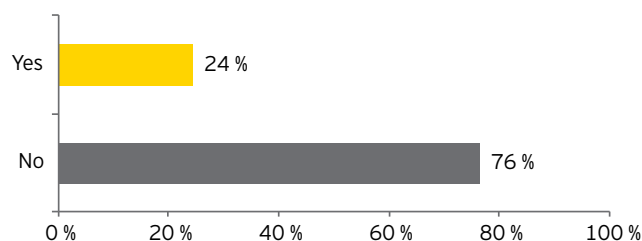


▶ Preserving capital

Companies that are not keen on refinancing

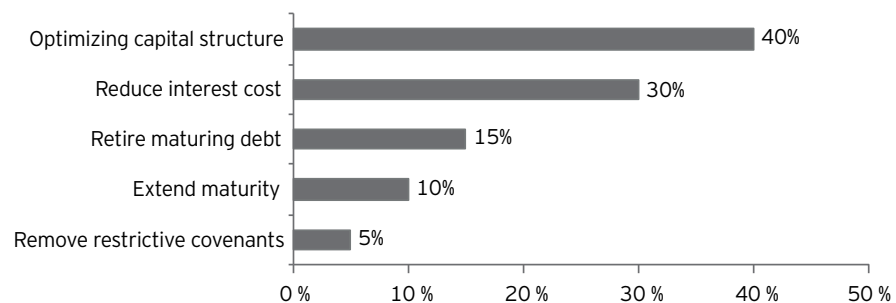
The majority of the respondents indicated that they do not plan to refinance their loans and other debt obligations during the next 12 months due to the current high interest rate scenario.

Do you need to refinance loans or other debt obligations in the next 12 months?



Refinancing existing loans will enable companies to optimize their capital structure and reduce their interest costs. Some of them are planning to opt for refinancing to retire their maturing debts.

What will be the primary purpose of your refinancing?

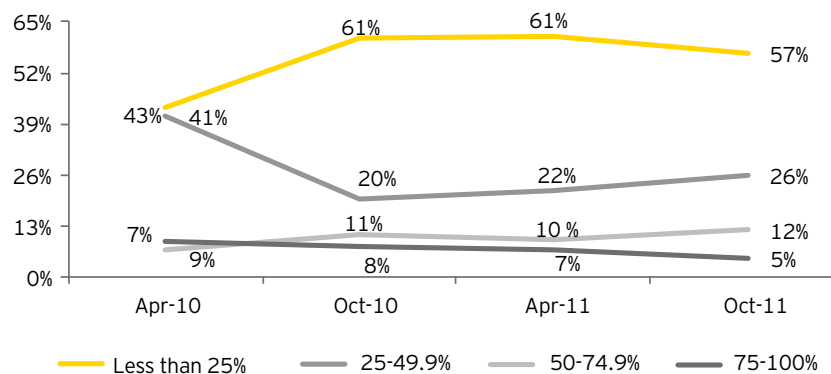


▶ Optimizing capital

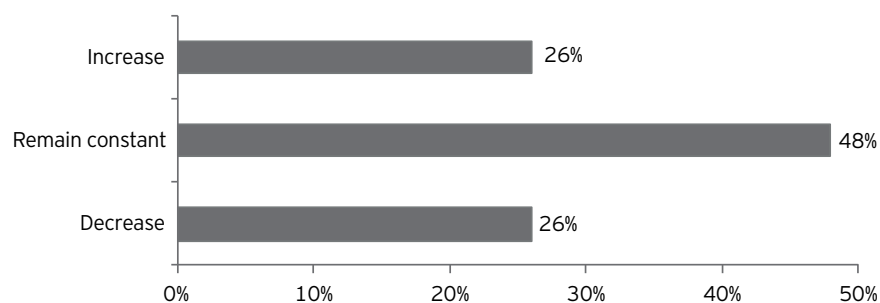
Continuation of deleveraging

Companies continue to maintain a low leverage ratio, with only 17% of them having a debt-to-capital ratio of more than 50% and 57% of less than 25%. Furthermore, around 48% of the respondents feel that their debt-to-capital ratio is unlikely to change in the next 12 months.

What is your current debt to capital ratio?

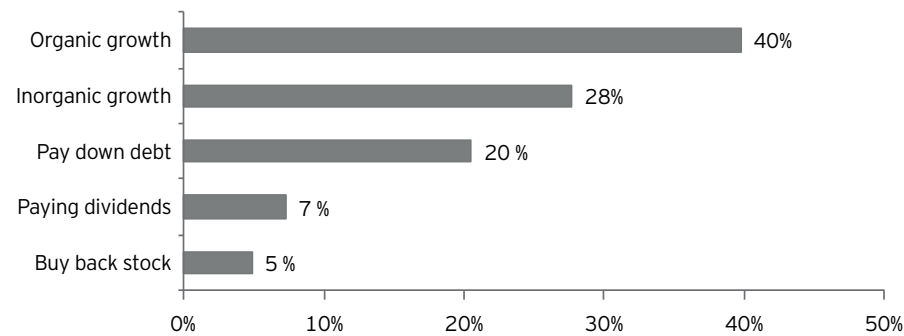


How do you expect your debt to capital ratio to change over the next 12 months?



Healthy cash reserves are fueling the desire for growth of many companies. Around 68% of them (with expected excess cash flow in the next 12 months) are prioritizing investment in growth, followed by 20% opting to pay off their debts to deleverage.

If you have excess cash, on which of the following will you focus over the next 12 months?

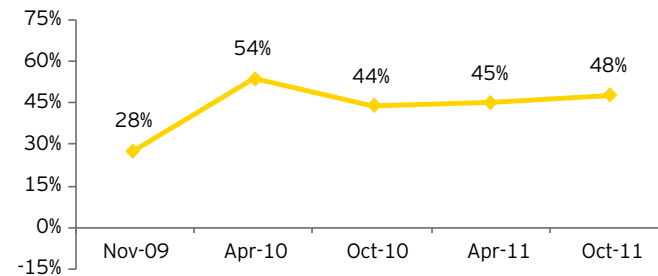


M&A outlook

Appetite for acquisitions on the rise again

Inclination for inorganic growth has been on the downside over the past one year. However, this trend is slowly picking up, with the companies once again looking to pursue acquisitions. Among the respondents, 48% expect to make acquisitions in the next 12 months, as compared to 45% in April 2011.

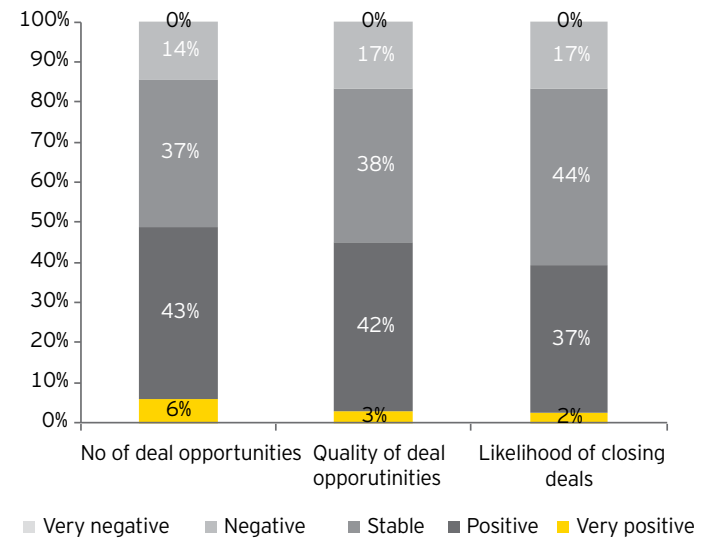
Do you expect your company to pursue acquisitions in the next 12 months?



Positive signals for deal making

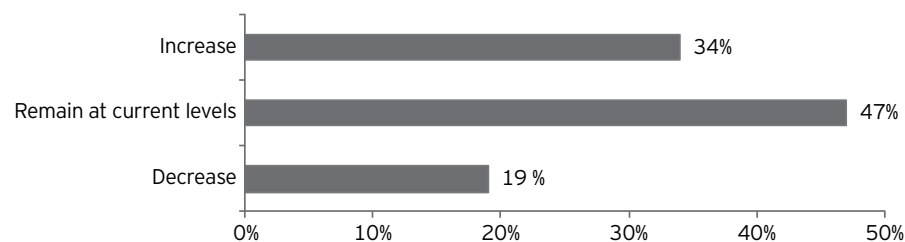
When asked to express their confidence regarding the volume and quality of deal opportunities and likelihood of closing deals, around 39%-49% of the respondents felt that the macro deal environment is positive or very positive, which is a favorable signal for future deal activity.

Please indicate your level of confidence in the following at the local level



The outlook on asset valuations indicates a conducive environment for M&A activity. Among the respondents, 47% expect asset valuations to continue at current levels in the next 12 months. However, with 34% of the respondents expecting asset prices to increase during this period, there is a possibility of increased deal activity due to buyers' attempt to make acquisitions before valuations rise.

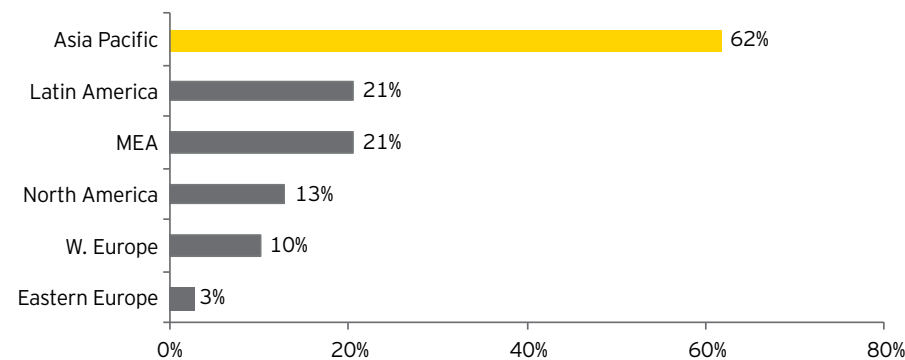
What do you expect the price/valuation scenario of assets to be over the next 12 months?



Asia-Pacific markets: top of the pick

Asia-Pacific countries are the most favored destinations for outbound Indian investments, with around 62% of the respondents likely to invest in these markets in their bid to obtain access to new markets and expand their operations to compete with international organizations.

Which are the top five regions in which you are likely to invest?



China, Brazil and the US are the top three destination countries for Indian companies expecting to make outbound acquisitions in the next 12 months. China is particularly favored for outbound investments because of its vast domestic economy, which can be a lucrative market for Indian companies. Brazil, South Africa, Australia and Nigeria, which are rich in natural resources, are also gaining popularity among Indian companies as they look to secure supplies for their operations.

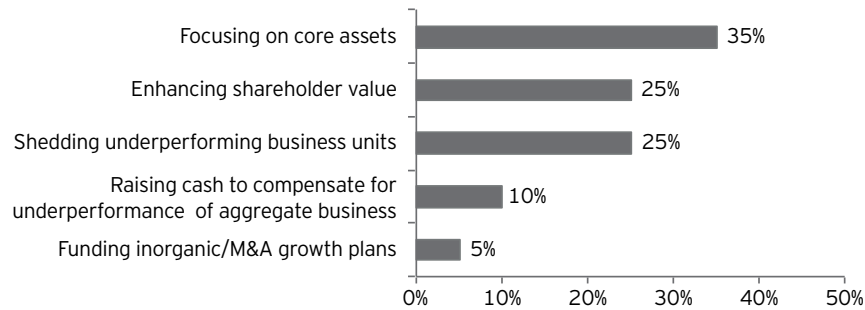
In their cross-border deals, which are the countries in which Indian companies are most likely to make acquisitions?

Rank	Destination country
1	China
2	Brazil
3	US
4	South Africa
5	South Korea
6	Singapore
7	Australia
8	UK
9	Sri Lanka
10	Nigeria

Divestitures losing steam

Around 86% of the respondents do not expect to pursue divestments in the next 12 months. The top three reasons for planned divestitures include focusing on core assets, shedding underperforming business ones and enhancing shareholder value.

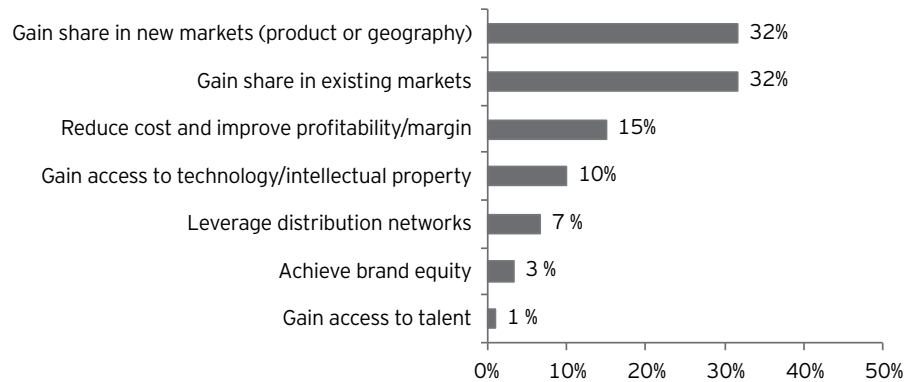
What are the main drivers of your company's planned divestment activity?



M&A drivers

The desire to grow revenues and market shares is driving the M&A scenario. Around 64% of the respondents indicated that their primary purpose in investing in a particular market was to gain a share in new markets (products and geography) as well as in existing ones. Achieving cost reduction, improving profitability margins and gaining access to technology or intellectual property are other top drivers.

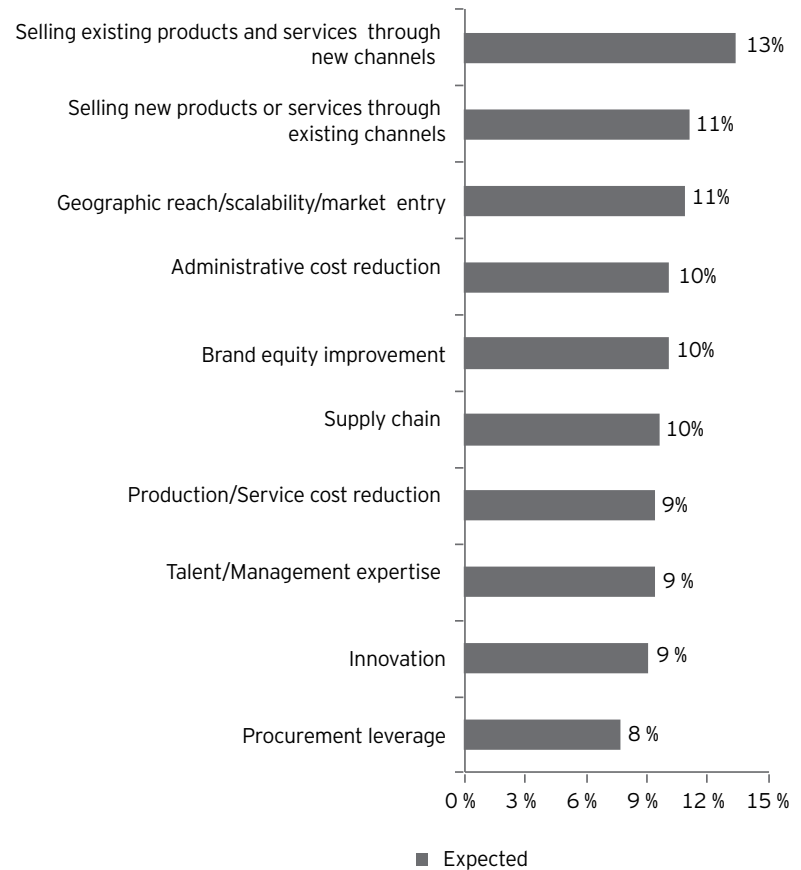
What are the main drivers of your company's planned acquisitions in your chosen markets/countries?



Value creators

Synergies achieved by selling existing products and services using new channels and selling new products or services using existing channels are the top areas in which value creation is expected. There are other areas in which companies found unexpected value creation – innovation, procurement leverage and talent/management capabilities.

Where did you achieve the most significant value creation in deals you have conducted in the last 12 months, which were expected or unexpected?

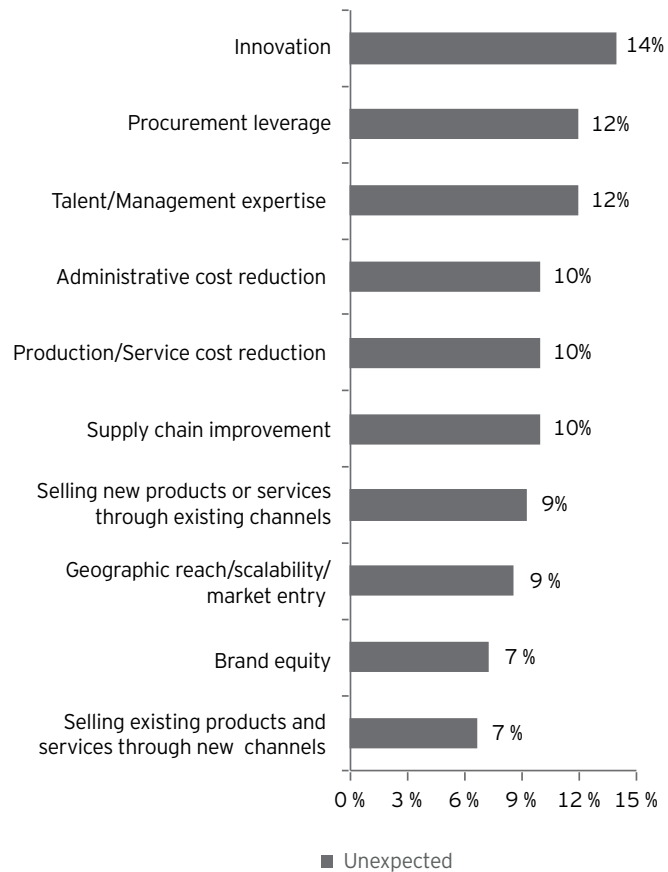
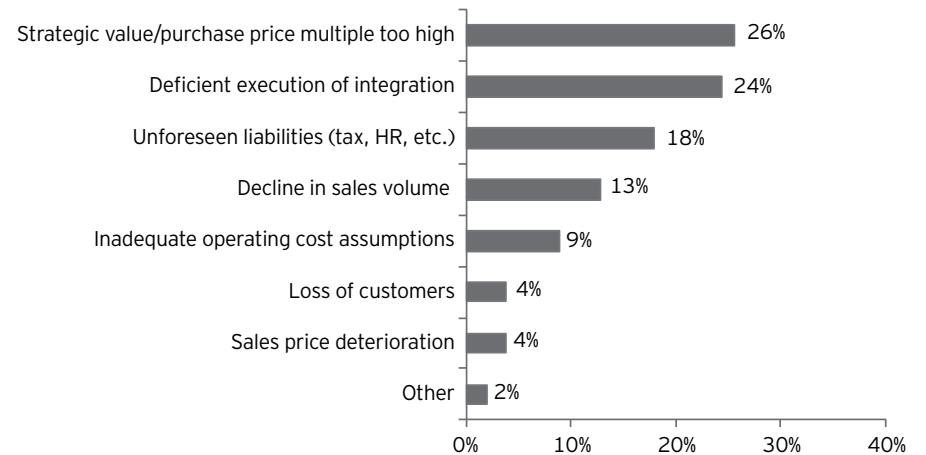




Opportunities for improvement

Overestimation of the strategic value of targets or purchase price multiples being too high is one of the significant factors that contribute to deals not meeting expectations. Deficient execution of integration processes is another key reason for deals failing to meet expectations.

In the case of recent transactions, what were the most significant issues that contributed to deals not meeting expectations?



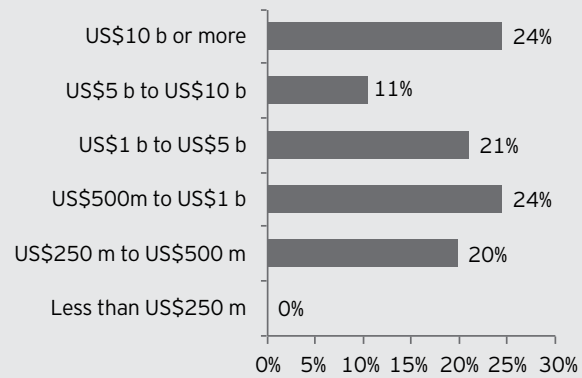
Conclusion

- ▶ Indian players are optimistic about the prospects of the domestic economy as well as their own businesses. Most respondents expect their corporate earnings to improve in the coming year, despite growing concerns about the implementation of tightening measures (due to increasing inflation) stifling the growth of the economy.
- ▶ Achieving growth is expected to be the focus area for most companies. They will continue to pay increased attention to resources to grow organically by investing capital in new products, R&D, and talent acquisition and retention. However, a slight increase has been noticed in the inorganic growth of companies as well as in their renewed interest in pursuing M&A deals during the coming year.
- ▶ Cash continues to be the primary source for funding transactions. Debt has also gained traction among Indian companies as a funding source, despite rising interest rates. However, there is low interest in deploying equity as a funding source due to the high volatility witnessed in Indian stock markets in recent times.
- ▶ The desire to achieve synergies by selling existing products and services using new channels and selling new products and services using existing channels is driving M&A activity. Asia-Pacific countries are the preferred destinations for outbound investments, followed by Latin America, the Middle East and Africa.
- ▶ Companies may adopt a cautious approach to deal with increasing regulatory pressures and uncertainties relating to valuations in the coming year. It may be worthwhile for them to pay increased attention to post-acquisition integration and conduct a fair estimation of the strategic value of a target to avoid entering deals that fail to meet expectations.

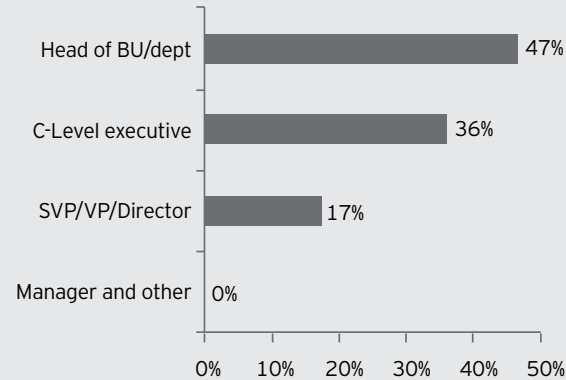


India: survey demographics

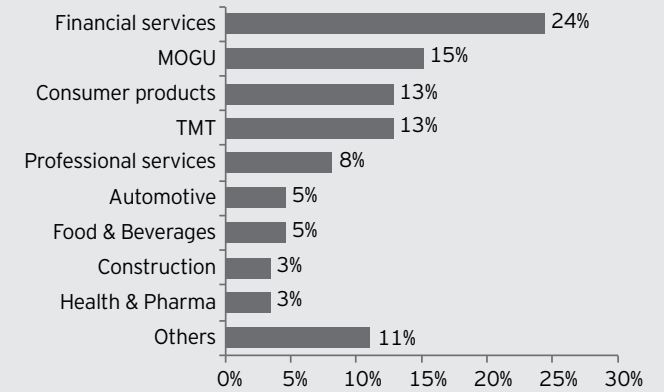
Indicate your company's annual global revenues in US dollars:



Which of the following best describes your job title?



In which industry does your company operate?



Note: Other sectors include education, government, hospitality and leisure, aerospace, defense, agriculture, agribusiness, and retail and wholesale.
Mining, Oil, Gas and Utilities (MOGU)
Technology, Media and Telecommunications (TMT)

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