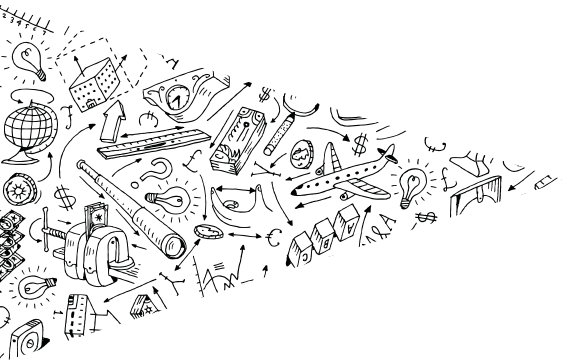


Capital Confidence Barometer



Capitalising on the recovery? The Australasian story

About this survey

Ernst & Young's *Capital Confidence Barometer* regularly takes the pulse of senior executives from leading companies around the world. In this snapshot of findings from our latest survey, conducted by the Economist Intelligence Unit (EIU), we provide an indication of corporate confidence in the economic outlook, boardroom priorities as well as emerging leading practices in the way companies manage their capital agenda.

Profile of respondents

- ▶ EIU panel of 817 executives surveyed in March 2010. 60 respondents from Australia and New Zealand
- ▶ Companies from 51 countries including Australia, New Zealand, China, France, Germany, India, Japan, Russia, UK and the US
- ▶ Cross-section of respondents from over 40 industries
- ▶ 329 CEO, CFO and other C-level respondents
- ▶ Up to 419 companies would qualify for the *Fortune* Global 500 based on revenues

The capital agenda

The Ernst & Young capital agenda helps you consider your strategic capital options throughout the economic cycle. It will help you with the decisions you need to achieve for market success. The four key areas of the capital agenda are:

1. Preserving capital: reshaping the operational and capital base
2. Optimising 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

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



Pip McCrostie
Global Vice Chair,
Transaction Advisory
Services



Graeme Browning
Oceania Managing Partner,
Transaction Advisory
Services

Six months on from our inaugural study, this second survey of executives from some of the world's largest companies has delivered interesting - and encouraging developments.

If we compare the latest results with the October 2009 findings, it is clear that you are telling us that not only has the broader economic outlook improved but also that the outlook for your industry generally is a more positive one.

You have switched your focus from paying down debt to actively pursuing strategies to grow your business and are now more willing and able to acquire. You are indicating that M&A is back on the agenda with many deferred investments now going ahead. As we head towards a post-downturn environment, it is apparent from your responses that there is now more than ever a strong requirement for greater transparency around future earnings of potential acquisition targets.

Fundamentally however, our findings continue to underline one critical fact: how you manage your capital today will define your competitive position tomorrow.

With the strengthening of the local economy and increasing optimism in the capital markets, those companies that have access to capital can use it to enhance competitive position. Many of you said you are preparing to raise and invest capital but at the same time, maintain cautious discipline around how you preserve and optimise your capital position.

In the following pages we share with you the highlights from the survey findings, giving a global perspective alongside the Australasian (Australia and New Zealand) context. It is our intention to revisit the *Capital Confidence Barometer* every six months in order to provide you with timely insights into the shifts in business sentiment both here and around the world.

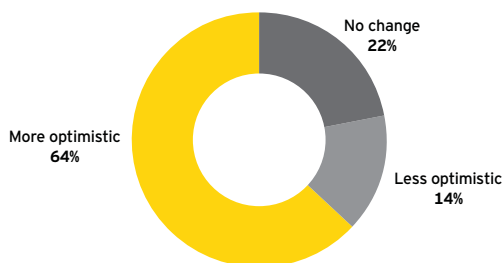
The *Capital Confidence Barometer* will help you identify the market challenges that may emerge tomorrow; our capital agenda can help you plan for those challenges today.

Key highlights

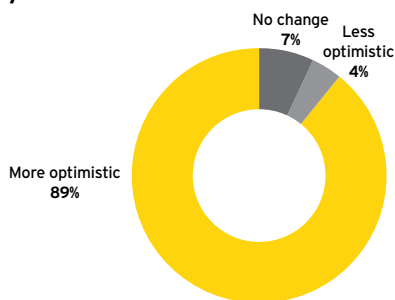
Economic outlook

- ▶ **Countdown to the end of the downturn begins:** Forty percent of global respondents believe the global downturn will end in the next 12 months compared to 30% who held this view in late 2009. Australasian respondents have a less optimistic view of the global economy: 26% currently believe the global downturn will end in the next 12 months with the majority of respondents - 58% - believing it will end within the next two years. Interestingly, this is an increase from the 2009 response, when 26% of Australian respondents thought the crisis would end within 12 months and 44% in the next two years.
- ▶ **Economic and company prospects have improved over the last six months:** Sixty four percent of global respondents indicate they are more confident about the prospects for their local economy than six months ago, with the highest levels of confidence reported by the Asia Pacific and Australian respondents. Ninety two percent of Australian respondents were optimistic about the strength of market opportunities at home, buoyed by robust activity in the resources sector. This was echoed in New Zealand, where 75% were optimistic about the future direction of the local economy.

Global: Compared to six months ago, are you more or less optimistic about prospects for the economy where you are based?



Australasia: Compared to six months ago, are you more or less optimistic about prospects for the economy where you are based?



89% of executives feel more optimistic about prospects for their company than six months ago.

- ▶ **75% of Australasian respondents expect the downturn in their own industries to end within 12 months:** Global respondents were less optimistic about prospects for their industry at 61%. Highest levels of optimism from a global perspective were noted in the automotive industry while in Australasia, the highest level of optimism was coming from those operating in the financial services sector.
- ▶ **69% of global executives are more optimistic about prospects for their company than six months ago:** Eighty percent of Australasian executives were viewing the future of their business as robust, with many reporting confidence in the effectiveness of their capital structures and an easing of liquidity constraints.

Capital markets

- ▶ **Capital and credit conditions are improving:** Twenty six percent of global respondents state that access to funding is not a problem for their organisation, however the residual 74% of respondents are not seeing an increase in availability. The Australasian story is more upbeat; 42% of executives indicate their business has no difficulty in obtaining access to finance. From the balance of respondents who cite funding restrictions, there is a view that access will open up within the next six months. These results exhibit an improvement in expectations from October 2009 findings when 53% of global respondents and 57% of Australian respondents believed that financing would not return to mid-2007 levels for at least another three years.
- ▶ **61% of global executives say that credit/capital conditions have improved in the last six months:** This compares with 50% of Australasian respondents who have seen an improvement in market liquidity. Interestingly, the other 50% of Australasian respondents indicate that conditions have not changed for them. As we reported in the last survey some large corporates have had and continue to have the benefit of strong balance sheets, are operating in cash-rich sectors and as a result find themselves with an unprecedented advantage in the transactions market.
- ▶ **Companies are now more focused on growth opportunities than paying down debt and dividends:** Cost reduction, customers and capital structures remain high on the agenda for most global and local companies in the next 12 months. A quarter of Australasian respondents - similar to their global counterparts - are conserving cash on the balance sheet.
- ▶ **Wave of refinancing expected:** Fifty eight percent of global respondents need to refinance loans or debt obligations in the next four years, highlighting that access to functioning capital markets remains critical. From an Australasian perspective, 63% of respondents either had no need to refinance or had completed their refinancing at the time of the survey. As noted in our previous study findings, the relative stability of our local banking system and the combination of direct stimulus and government assistance to the finance sector helped set the scene for continued credit availability.

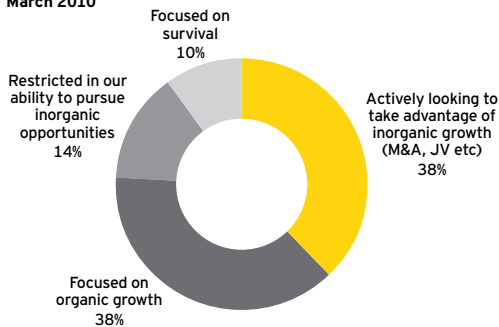
Confidence

Mergers and acquisitions (M&A) outlook

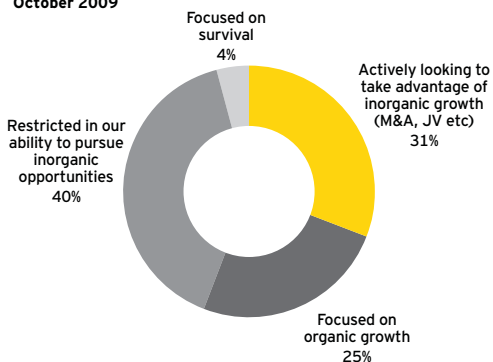
- ▶ **Companies expect to grow through M&A:** Transactions are increasingly likely to receive attention over the next 6-12 months. Forty seven percent of global companies are expecting to make an acquisition in the next six months compared to 25% in 2009. A similar percentage of Australasian respondents (45%) are intending to transact in the next six months, up from 29% in 2009.
- ▶ **Fewer feel restricted:** Globally, organisations are feeling better equipped to pursue inorganic growth, with the number of companies who say they are constricted to pursue opportunities falling by 26% since 2009. From the Australian perspective there was a comparative fall of 29% since 2009.
- ▶ **Increase in those focused on survival:** In 2009, 4% of global companies and 3% of Australian companies indicated they were vulnerable and considering options to avoid insolvency. While the Australasian response to the current survey is a healthy zero, the global response has jumped to 10%. It may be that some organisations have been permanently impaired by the downturn. A high proportion of global respondents are based in the United Kingdom and the United States, economies that continue to face significant uncertainty and the wind-back of government stimulus programs.

Global: Which statement best describes your organisation's focus over the next six months?

March 2010



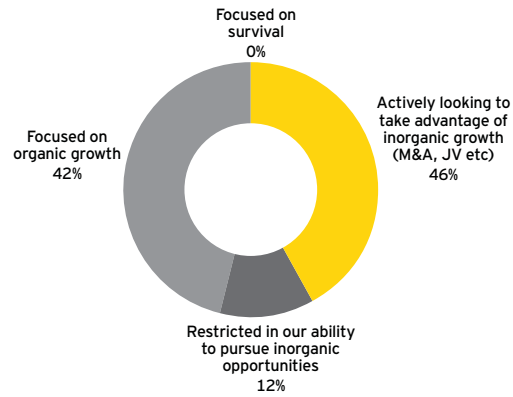
October 2009



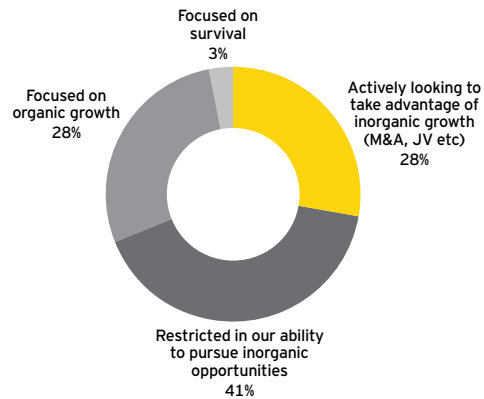
45% of companies are expecting to make an acquisition in the next six months compared with 29% in 2009.

Australasia: Which statement best describes your organisation's focus over the next six months?

March 2010



October 2009



- ▶ **Appetite to acquire exceeds the desire to sell:** Overall, among global and Australasian respondents there is a greater propensity to acquire rather than divest. Acquisitions in emerging markets are now seen as more desirable than in 2009 by both groups of respondents, up at the expense of investment into developed markets. The appetite to divest remains low, and has in fact declined since 2009.
- ▶ **Buyers need clarity around future earnings potential:** Both our global and Australasian respondents acknowledge more time and attention is now being paid to synergy attainment as well as to assessing forecasts and future market potential.

Preserving

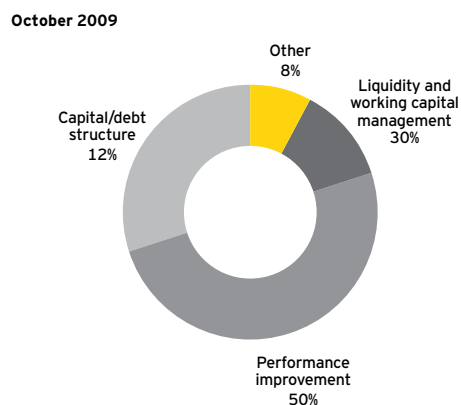
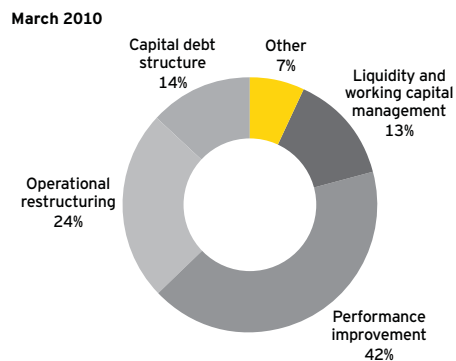
Results

Preserving capital

For our global respondents, compared to six months ago, liquidity is less of an issue. At that time, 72% of Australian respondents cited liquidity management as an aspect of their business that was expected to receive increased attention. In the current survey, the expectation from executives of the level of scrutiny around cash flow has reduced by 35%.

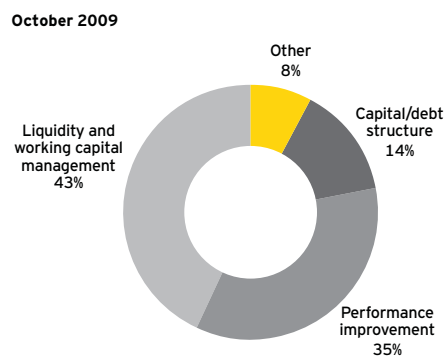
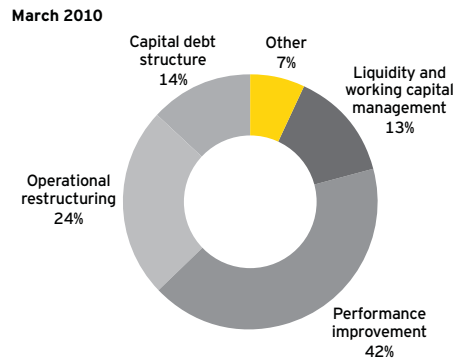
While companies are continuing to operationally restructure their businesses to drive performance enhancements, many perhaps feel that they have already conducted this process. Australasian respondents, in line with global counterparts, are giving more of their attention to restructuring acquired businesses - 45% and 47% respectively. The primary motivation for the restructure revolves around achieving performance improvement or aligning operating models.

Global: When restructuring, what will be your main priority?



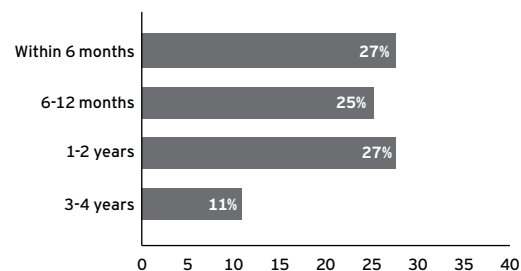
35% of companies need to restructure their core business, a 15% decrease from six months ago.

Australasia: When restructuring, what will be your main priority?

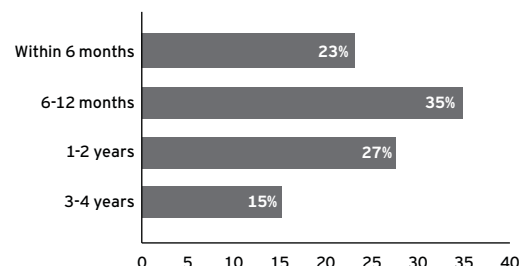


As previously noted, 58% of global respondents and an average of 37% of Australasian respondents will need to refinance loans or other debt in the medium term. Of those needing to refinance, 63% of global respondents intend to do so in the next 12 months and 89% in the next two years. From an Australasian perspective, 58% plan to refinance in the next 12 months and 85% in the next two years.

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



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



Optimising capital

Companies continue to look hard at their operational fitness. The top five areas of focus for organisations for the next 12 months are:

Global	
1. Operational efficiencies / cost effectiveness	63%
2. Cash flow / liquidity	44%
3. Customer segmentation / profitability	34%
4. Acquisitions	24%
5. Capital structure	24%

Australasia	
1. Operational efficiencies / cost effectiveness	57%
3. Customer segmentation / profitability	43%
2. Cash flow / liquidity	35%
4. Acquisitions	33%
5. Supply chain/risk performance	27%

While not a high priority pre-downturn, driving a culture of cash and working capital is now more important than ever. Eighty six percent global and 89% of Australasian companies have reviewed their working capital processes and made sustainable improvements.

The last 18 months has driven organisations to optimise and release capital to fund growth opportunities. Businesses that do not enhance the core or generate sub-optimal returns are front of mind when considering divestment strategy.

When looking to optimise the asset portfolio, global organisations are first considering the potential for organic growth through investment in the existing business. Companies are looking at the opportunity to create cost efficiencies across existing assets as well as the ability to maximise operational synergies in the portfolio. The considerations of Australasian organisations around optimisation of the asset portfolio in the main align with their global counterparts; however they do place greater emphasis on acquisition, partnership or joint venture as a route to market leadership. To give further context to this point, 77% of global respondents and 81% of Australasian respondents rate synergy identification and realisation as a high priority when planning and structuring transactions.

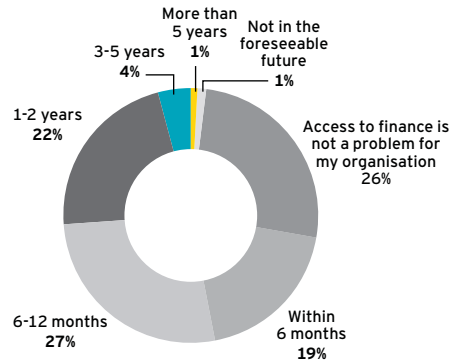
In our inaugural study we highlighted the importance of preparation and planning of transactions as critical to value; this starts with highly focused pre-acquisition diligence. The findings from our recent study suggest that executives are still not satisfied with the underlying results from their acquisitions or divestments with 32% of global companies, and a similar number of Australasian respondents, stating that their last transaction did not meet expectations or was not actively monitored in terms of value achieved.

81% of respondents cite synergy identification and realisation as a high priority when planning and structuring transactions.

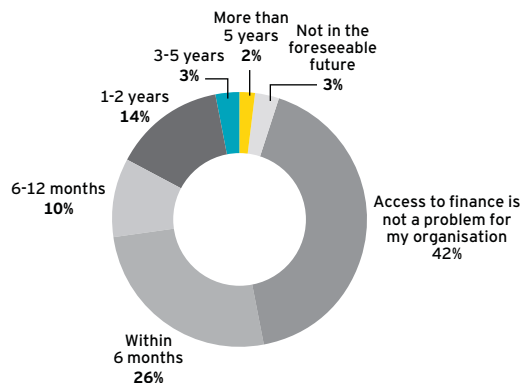
Raising capital

Most likely to acquire are the 26% of global respondents and 42% of Australasian respondents who state that funding for capital projects is not an issue for their organisation.

Global: When do you expect financing to be available to fund major acquisitions and/or capital projects for your organisation?



Australasia: When do you expect financing to be available to fund major acquisitions and/or capital projects for your organisation?



The use of debt to fund M&A transactions continues to decline. Cash remains the single largest source of funding - preferred by 54% of global respondents and a similar percentage of Australian respondents. In contrast, New Zealand respondents are still reliant on debt as much as cash.

Overall the breadth of sources being explored in 2009 - such as bonds and rights issues - has declined in our current survey as traditional bank financing options become more readily available for those with stronger credit characteristics.

Valuation and pricing concerns continue to limit the use of divestments to raise capital; 38% of global transaction executives expect to make a divestment in the next six months - nearly double those in 2009. In Australia, 36% of respondents are considering a divestment in the next six months, also double those in 2009. For our New Zealand respondents, divestments as a capital raising strategy, are low on the agenda.

Protecting value during the sales process is challenging with buyer confidence remaining fragile, the global downturn having had a significant impact on the evolution of deal evaluation. Fifty one percent of sellers in the global market and 55% in the Australasian markets are focused on providing buyers with greater visibility of assumptions and forecasts.

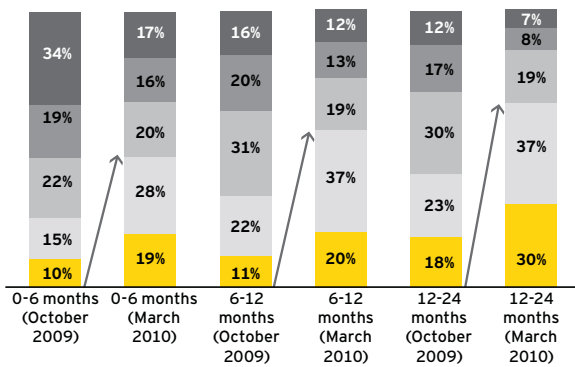
Investing capital

Many respondents recognise the investment opportunities offered by a recovering market. In the near term, capital is most likely to be allocated to growth opportunities offered organically and through M&A activities, rather than being channelled into debt repayment or shareholder dividends. The top three allocations for capital cited for both global and Australasian respondents are organic growth, inorganic growth and research and development. Returning excess capital, particularly that raised recently to bolster balance sheets and support refinancing, is not yet seen as a palatable option among respondents.

As previously noted, almost half of global and Australasian organisations expect to make acquisitions in the next six months, with this figure rising to over 60% in the next two years for both groups of respondents.

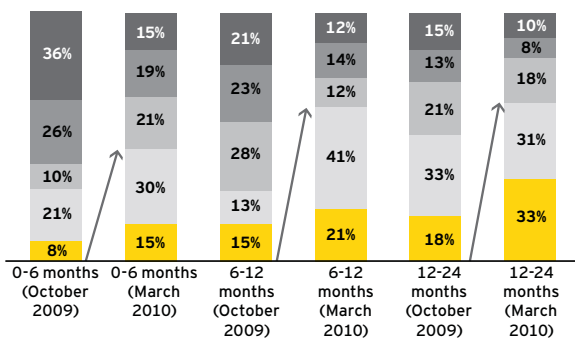
Global: How likely is your company to execute acquisitions in the following time periods?

■ Highly likely ■ Likely ■ Neither likely or unlikely ■ Unlikely ■ Highly unlikely



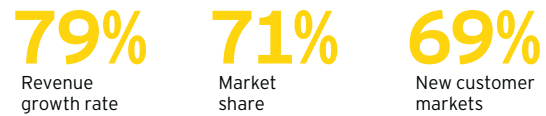
Australasia: How likely is your company to execute acquisitions in the following time periods?

■ Highly likely ■ Likely ■ Neither likely or unlikely ■ Unlikely ■ Highly unlikely

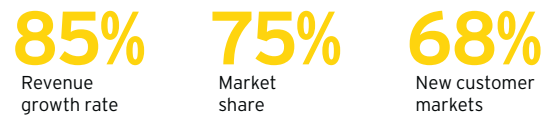


As more companies focus on growth rather than balance sheet repair, those that can demonstrate real revenue and market share growth along with routes to new customer markets stand out, thereby attracting more investment capital.

Global



Australasia



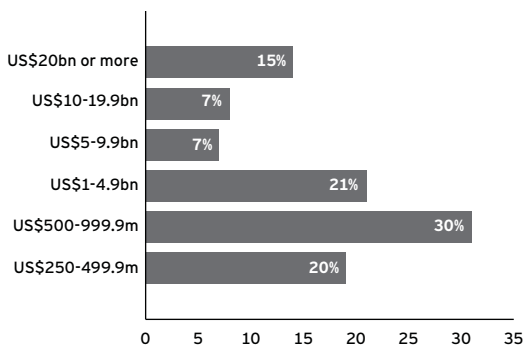
When planning and structuring transactions, 78% of global and 82% of Australasian organisations rank the ability to identify and mitigate risk as highly important, closely followed by synergy identification and realisation.

Conclusion

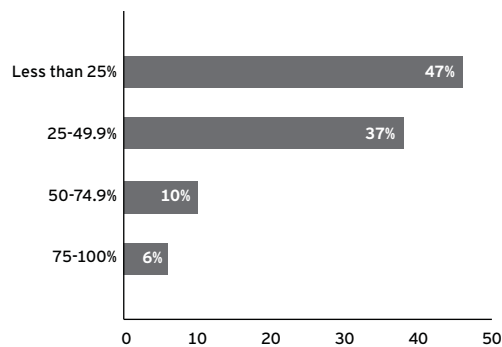
- ▶ Economic prospects are seen to have improved in the last six months. Confidence, albeit measured, is returning to the markets.
- ▶ A growing number of companies are less restricted in funding growth opportunities; however most continue to face capital constraints in the execution of strategic objectives.
- ▶ Given lack of funding for investment opportunities over the last 18 months, companies with access to capital are now using that capital to fund organic and acquisition-related growth rather than paying down debt or paying dividends.
- ▶ First-mover advantage will go to a few highly motivated and bold acquirers. Major deals within industries will likely pressure others to respond.
- ▶ For those making acquisitions, the deal process is evolving. More time and attention is being paid to synergy attainment as well as assessing forecasts and future market potential.
- ▶ The significant support package announced by European regulators to address the real risk of debt default by several member states underlies just how fragile the nascent global recovery in confidence and credit markets remains. A reversal of the improvements shown in the *Capital Confidence Barometer* cannot be completely discounted.

Survey demographics

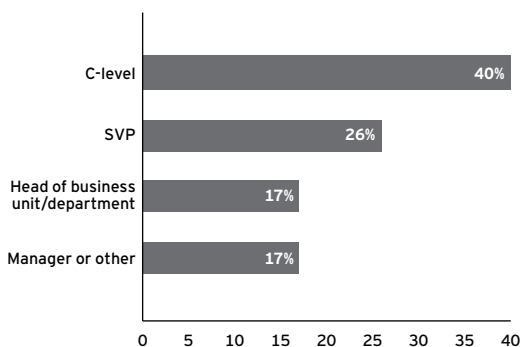
What are your company's annual global revenues in US\$?



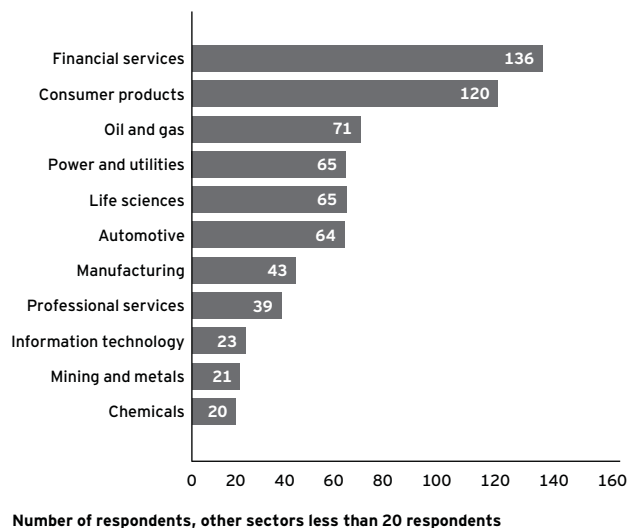
What is your current debt to capital ratio?



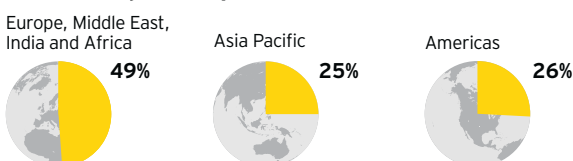
What is your position in the organisation?



In which industry is your company located?



In which region are you located?



Contacts

We explore each element of the capital agenda in more detail in our report *Why capital matters*. If you would like to discuss your company's capital agenda, please contact your usual Ernst & Young adviser or any of the contacts listed below.

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