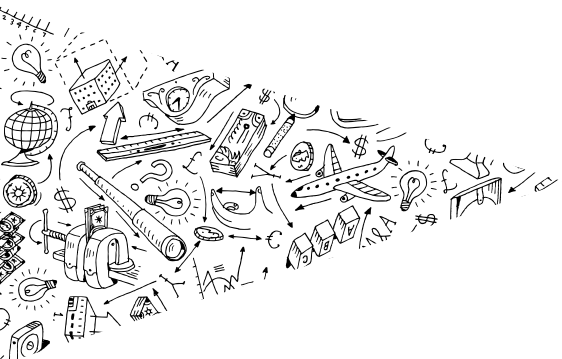


Global Capital Confidence Barometer UK



Time to act

About this survey

Ernst & Young's Global 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 UK 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, including 119 executives from the UK
- ▶ Cross-section of UK respondents from nearly 20 industry sectors
- ▶ UK company revenues ranged from US\$250 million to over US\$10 billion

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. **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

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.

On the domestic front, the UK economy is uniquely placed, outside of the problems in the US economy and Eurozone sovereign debt challenges, but dependent on both for the export-led recovery called for by many politicians. The barometer indicates that businesses do not anticipate a strong rebound and, indeed, expect current difficulties around credit conditions and market volatility to persist. Politicians across the world must offer concerted action before any form of stabilisation will occur, and UK businesses recognise that they can no longer rely on the rising tide of economic growth to deliver adequate shareholder returns.

Nonetheless, the deleveraging engaged in by UK corporates following the 2008-09 financial crisis has left them in a better shape to respond to the difficult economic situation and low growth environment. Many companies are prepared to pursue diverse capital strategies, across developed and emerging world M&A, strategic divestments, working capital management and corporate restructurings. Innovative deal making and bold transactions may be the only way to deliver growing corporate earnings in such straightened macroeconomic times.

The barometer indicates that now, more than ever, a clear and well-executed capital strategy is the only way for UK companies to grow in a growth-less macroeconomic climate. Those who respond decisively and act now, rather than sitting on cash, will be those whose businesses succeed.



Pip McCrostie
Global Vice Chair
Transaction Advisory Services



Jon Hughes
UK and Ireland Managing Partner
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Our perspectives

- ▶ Growth expectations in the UK lag behind global averages, and UK respondents expect significant short-term volatility in the markets. The outlook is underlined by the fact that our polling was done in July and August, i.e., before the recent market upheaval.
- ▶ In contrast to the majority of other countries, UK participants rate the domestic economy as weaker than the global average, with over half anticipating stagnation or a return to recession.
- ▶ Job creation remains weak and a quarter of UK companies are planning to cut further jobs in the next 12 months.
- ▶ Credit conditions in the UK remain tight by international standards, and UK respondents plan to deleverage or maintain current capital structures in response, with less than a third planning to use debt to fund deals.
- ▶ Against international trends, a majority of UK participants identified excess working capital as a source of funding, indicating an area for innovative and competitive value creation.
- ▶ In spite of these significant headwinds, UK companies remain focused on growth, with a largely stable outlook for corporate earnings. Since, clearly, such growth cannot be generated by relying on general economic growth, a dynamic capital strategy is required.
- ▶ According to our respondents, tax and banking reform remain the greatest risks to growth.
- ▶ Corporates are therefore looking to M&A activity, especially in emerging markets, to drive value creation, with a majority of respondents anticipating acquisitions and a third divestments in the next year.
- ▶ Valuations are attractive in current market conditions for buyers, whilst sellers will remember the even riskier environment of 2008/09.
- ▶ UK foreign investments follow international trends towards emerging markets, whilst retaining a European focus.
- ▶ Value in M&A is sought in leveraging existing businesses by selling in new markets, selling new products in existing markets, by scaling business models or achieving cost synergies.
- ▶ Overestimating value and poor integration execution are cited as chief reasons for the failure of deals.

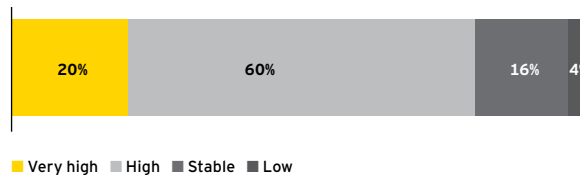
Economic outlook

July and August marked a return to volatility not seen since the early days of the economic crisis. The US credit rating downgrade, debt crisis in the Eurozone and weakening economic data from around the world sparked dramatic stock market activity and ultimately the global re-pricing of risk. We have now moved into the third stage of the financial crisis from banking and real estate, to corporates and consumers, and now sovereign debt and currencies.

UK capital market conditions volatile

Notwithstanding the fact that the barometer reflects attitudes to risk in July and August 2011, the results indicate that the UK had been hard hit by capital market volatility even before September's turbulence, with 80% of respondents predicting high or very high short-term volatility. The unsettling developments in the sovereign debt markets of the US and the EU, Britain's two largest trade partners, clearly imply continued volatility in the UK's own markets, and would normally therefore indicate a slowdown in deal making.

What is your view of the likely short-term volatility of the global markets?

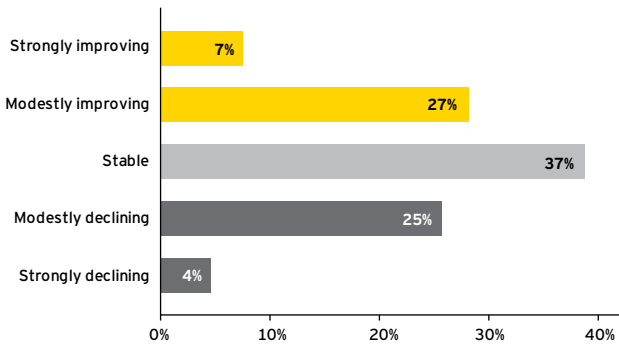


Bucking a strong trend for international competitors to rate their domestic economy's prospects as better than the international aggregate, UK participants identified expectations of either economic stability (with 36% expecting stability) or a return to recession (48% predicting either strong or moderate declines in economic output).

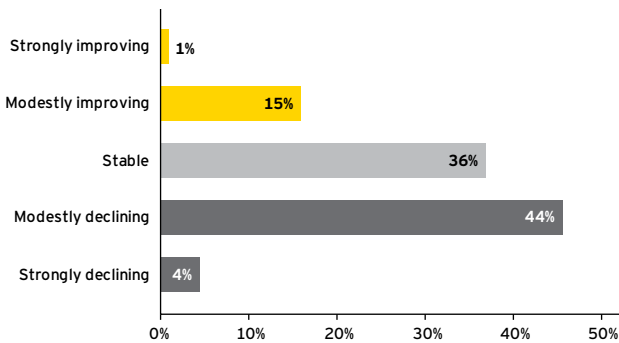
In the context of weak UK growth – only 16% of participants anticipate economic improvement, versus 34% of global participants – firms will increasingly need to develop an international strategy in their deployment of capital.

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

Global results



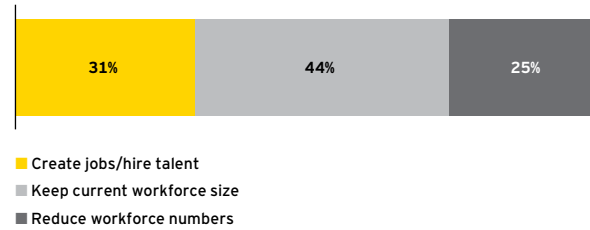
UK



UK employment outlook remains difficult

Whilst internationally, 86% of the Ernst & Young 1,000 expect to maintain or increase their workforce over the next 12 months, a quarter of UK respondents anticipate making layoffs in the following year.

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

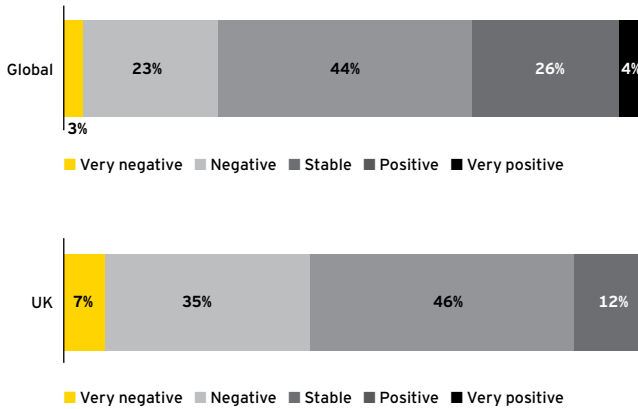


Capital funding

Credit conditions still tight but opportunities exist

Globally, a quarter of respondents felt pessimistic about credit availability, whereas the UK continues to suffer the fallout from the financial crisis and 42% of respondents are negative or strongly negative about the availability of loans, in spite of the commitments made under Project Merlin.

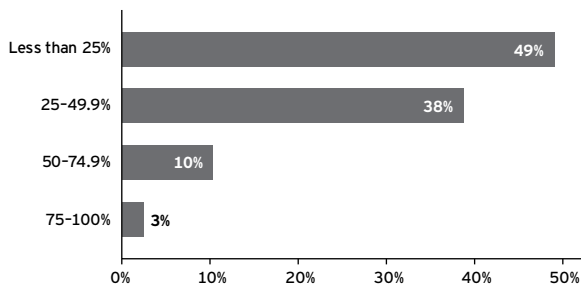
Please indicate your level of confidence in credit availability at a local level:



Leverage remains stable

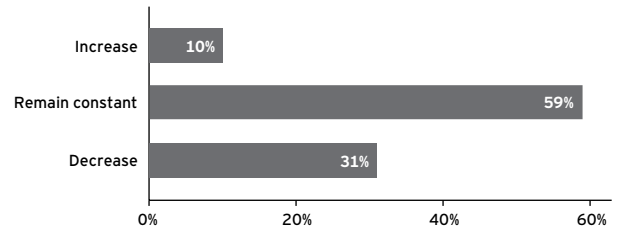
Whilst international competitors deleveraged slightly during the past six months, seeing an increase from 58% to 61% in the number of participants having gearing of less than 25%, the UK actually saw the number dip from 52% to 49% between April and October 2011.

What is your current debt to capital ratio?



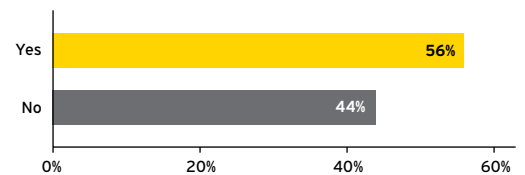
However, only 10% of UK respondents wish to increase leverage in the next year (compared to 22% globally), indicating that we will see a continuation of the recent trend towards corporate and individual deleveraging.

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



When exploring their options for financing deals, UK companies may be making good use of a significant opportunity. Only 47% of respondents globally said they viewed the excess working capital of an acquired company as a source of deal funding, compared to 56% of UK respondents.

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



With Ernst & Young calculating that up to US\$1.1 trillion of working capital could be released through working capital efficiencies by just the 2,000 leading US and European companies,¹ this significant source of deal finance represents an opportunity for innovative deal making and significant value add, where the UK is at a competitive advantage.

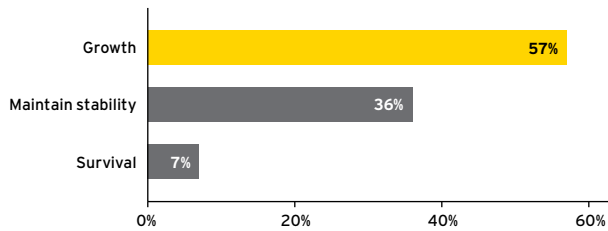
1 Ernst & Young's All tied up – Working capital management report 2011.

Growth

Growth primary focus for UK C-Suites

Most UK companies (93%) are focusing on stabilising and finding opportunities to grow their business in the next 12 months. The proportion of UK respondents focused on growth (57%) was 8% higher than the international average. Only 7% cite survival as an imperative – the lowest level since the barometer was first published in 2009.

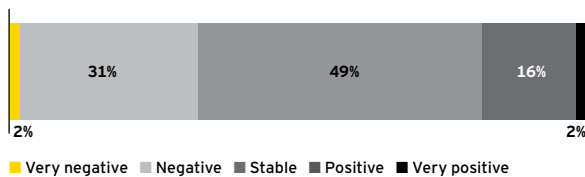
Which statement best describes your organisation's focus over the next 12 months?



Corporate earnings outlook stable, but weaker than competitors

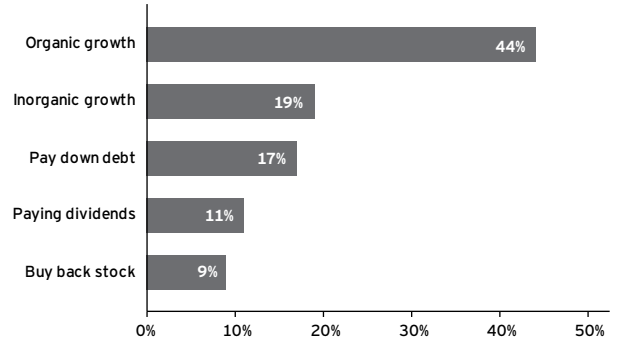
Overall, 67% of UK respondents felt that corporate earnings were like to be stable or growing, but only 18% felt positive, compared to 33% globally. They were outweighed in the UK by those who felt negative, at 33%.

Please indicate your level of confidence in corporate earnings at the local level:



For those with excess cash flow in the next 12 months, nearly two-thirds of all companies (63%) prioritise investing in growth, followed by paying down debt and deleveraging, in line with global trends.

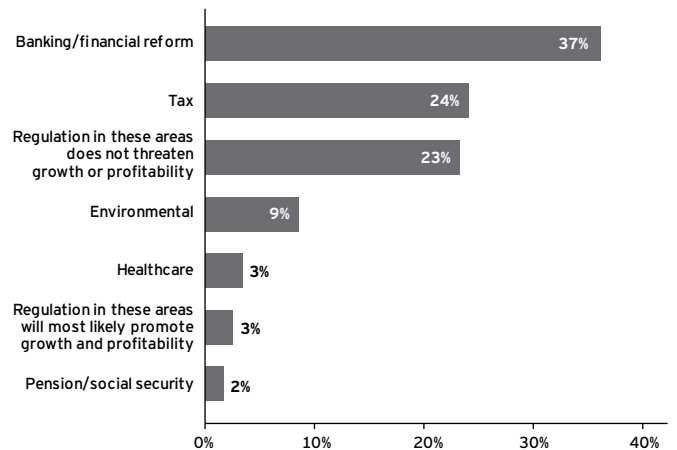
If you have excess cash, which of the following will be your priority over the next 12 months?



Regulatory environment impacts growth

The proportion of companies unconcerned by regulation (23%) is higher than the global equivalent (14%) reflecting the relative political stability of the UK. Concerns focused around financial reform and tax policies, key areas of contention within the Coalition government. Added to these must now be the significant risk that no adequate solution will be found to the sovereign debt crisis: a much more pressing concern for UK corporates.

What areas of regulation pose the most significant risks to growth and profitability for your organisation over the next 12 months?



If financial firms are excluded from the analysis, the largest concern is tax (28%), those reporting no problems (27%) and banking reform (25%).

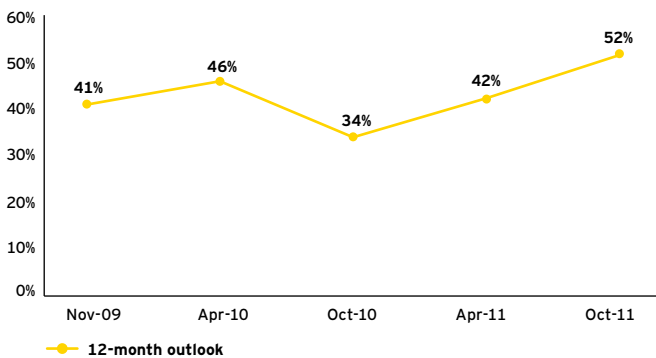
Mergers and acquisitions outlook

Appetite for deals surprisingly resilient

Overall there is a positive outlook for the M&A environment in the UK. The proportion of respondents expected to acquire in the next 12 months rose to 52%, the highest since the inception of the Capital Confidence Barometer, and a considerably higher number than the global average of 41%.

UK corporates have reduced their financial risk as a result of massive deleveraging, allowing them to consider adding more business risk in the form of mergers and acquisitions. Corporates may also be keen to avoid the kind of missed opportunities they faced in the wake of the last global slump, when much value was snapped up by less reticent private equity buyers.

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

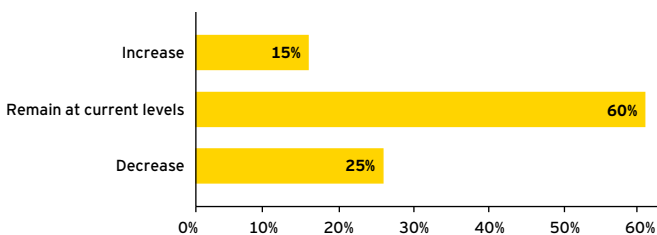


Favourable valuations attract buyers to the market

Market volatility is reflected in the divergent views on valuation and asset pricing. Whilst 60% of respondents felt that valuations would remain broadly flat over the next year, this largely reflects uncertainty and the risk of economic stagnation.

Depressed asset prices may attract value buyers, as in Vodafone plc's current talks to acquire Wind's business in Greece, surely the most downbeat of markets.

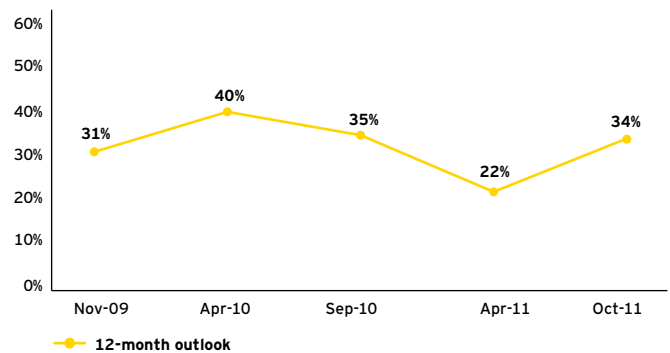
What do you expect the price/valuation of assets to do over the next 12 months?



Increasing divestment levels supporting activity

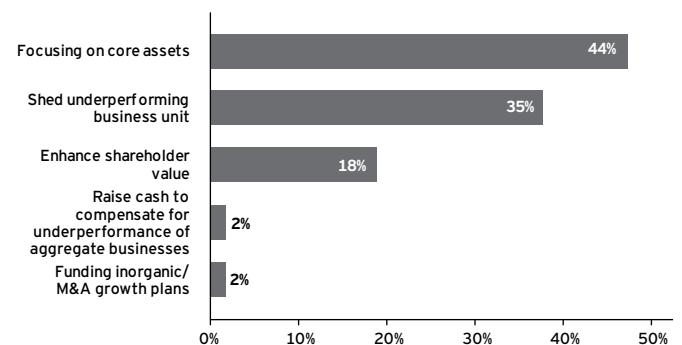
Willingness of companies to divest assets is obviously an important element to the deal market. Thirty-four percent of UK companies indicated that they expected to make divestments in the upcoming year. This reflects a rebound from the falls seen in recent barometers and more willingness to make divestments than the international average.

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



The top three reasons for executing planned divestitures are focusing on core assets, shedding underperforming business units and enhancing shareholder value.

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



Survey demographics

UK companies were significantly less likely than the global average to undertake divestments to raise cash to compensate for underperformance or to fund M&A (averaging 13% and 14% globally, respectively), indicating that divestments are focused on achieving strategic goals and creating value.

BRIC countries will continue to attract global investment capital

In an increasingly global economy, many respondents continue to pursue investment opportunities beyond their local geographies. Asian emerging markets are among the most attractive due to their high growth potential, expanding domestic demand and resilience to the current market volatility.

What are the five most likely countries where you will make outbound investments?

Global

1. China
2. India
3. Brazil
4. US
5. Australia

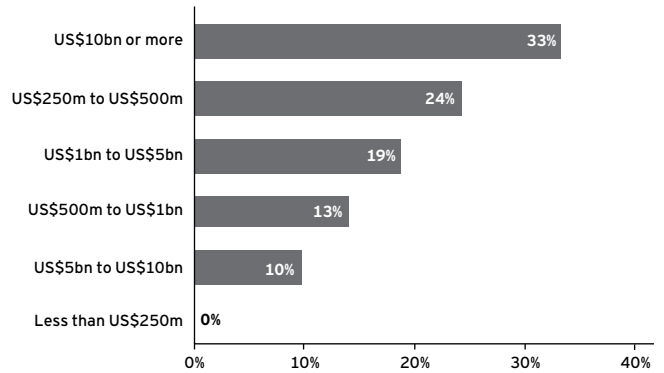
UK

1. China
1. Brazil
2. US
3. India
4. Germany

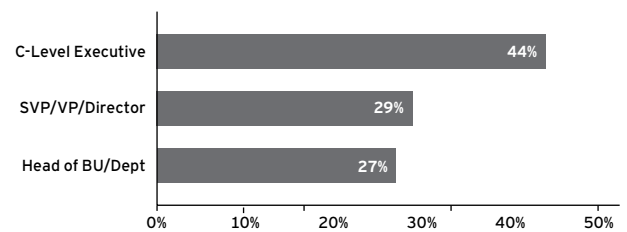
The greatest region for British investment was Western Europe, against Asia-Pacific globally. However, UK respondents rated Latin America more highly than North America, and Asia-Pacific more highly than both, indicating that the UK is still pursuing strategic investment in emerging markets.

119 In the UK, 119 companies were polled, representing the broadest Capital Confidence Barometer to date.

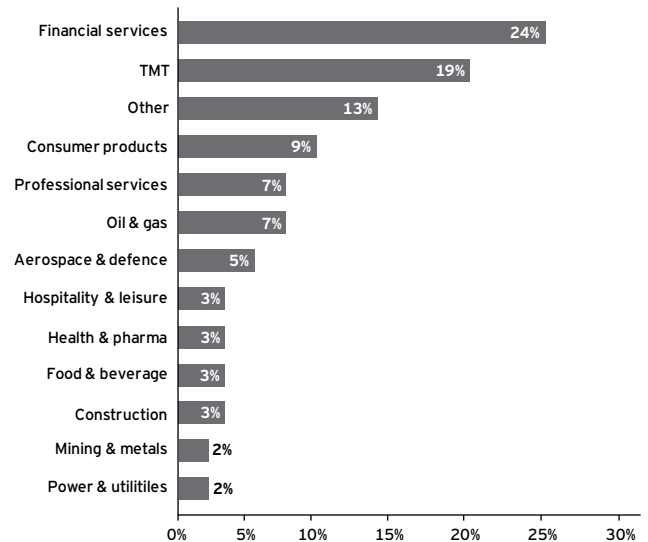
Breakdown by revenue



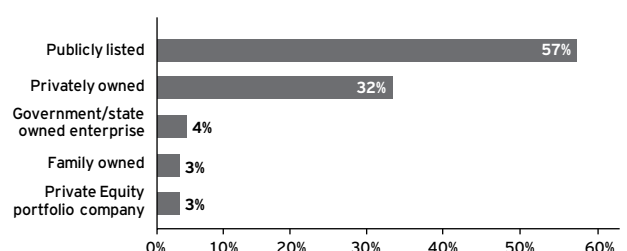
Breakdown by respondent



Breakdown by industry



Breakdown by ownership



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

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