Dealmaking returns?

M&A
More but smaller deals expected

Economic outlook
Confidence rises

Access to capital
Credit availability drives momentum

Growth strategies
Investment intent tops Capital Agenda
Dealmaking returns?
Growth mandates – driven by increased confidence and credit availability – are likely to spur M&A activity in CSE region

Key findings

87% expect global M&A and deal volumes to improve or remain stable
59% see the global economy improving
41% consider growth their primary focus
25% plan to pursue an acquisition
29% have a greater focus on investing in emerging markets
80% view credit availability as stable or improving
67% plan to use more leverage as deal size increases
“Executives in CSE region expect stable or increasing number of rather smaller transactions which is supported by a fairly favourable M&A environment, such as stable local economy, improved credit availability and strengthened focus on growth”

A note from Vladislav Severa, Head of Transaction Advisory Services, Central and South-East Europe

Our latest Capital Confidence Barometer suggests a return of deal activity after a period of falling M&A in the Central and South-East Europe region (CSE). The fundamentals are in place to foster M&A: confidence in the local economy is stable; cash is in abundance, and credit is readily available.

This does not mean we will see a return to boom-time dealmaking. That was unsustainable, but so is the deal recession we have experienced since 2009. Strategies to improve operational efficiencies have been largely implemented—organic measures alone can no longer meet growth mandates. Many will now need to consider inorganic options.

Confidence in closing deals has significantly increased, as have the number and quality of M&A opportunities since a year ago—this is strengthening buying intentions. A decent amount—36% of executives expect an increase in deal activity in the global market and approximately one quarter of them plan to act themselves.

The ongoing culture of M&A caution is understandable given the unprecedented economic turmoil we have experienced, and the market remains very sensitive to geopolitical issues—further shocks would prolong short-term breaks in deal flow. However, with organic growth measures providing diminishing returns, M&A will be the only route to meaningful growth. So, barring further major economic shocks, M&A and investing will return to prominence on the capital agenda.

While no-one can accurately predict when sustained momentum will return, we are seeing an uptick in transaction volume. If that trend continues, there will likely be bold moves across a number of key sectors in the coming months. If those bold moves are seen to establish a competitive advantage, then the “you first” sentiments that have clouded deal decisions in recent years could quickly turn into a “me first” engine for M&A growth locally.
Economic outlook – confidence rises

Executives are more optimistic about the global economy than at any point in the last year.

24% of all executives are confident the economy is stable, and more than one half believe it will improve at an accelerating rate. The outlook for Europe has brightened in the last six months. Higher levels of employment, rising GDP and more access to capital provide evidence that the region’s economic downturn is subsiding. This overall positivity will drive dealmaking globally and across multiple industries as short-term market stability returns.

Economic confidence reaches one-year high

Confidence levels have risen dramatically over the last 12 months—a clear indication the economy is improving at an increasing rate. This confidence resonates from stable underlying economic fundamentals, particularly in mature markets along with growing GDP, credit availability and increased job creation. Those who see the global economy declining fell to 17%.

Growth expectations continue to rise

More than half of all respondents anticipate growth of the local economy. This correlates with companies increasing ability to invest and stakeholder demand for meaningful growth.
Optimism prevails

Q: What is your perspective on the state of the global economy today?

<table>
<thead>
<tr>
<th>State</th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improving</td>
<td>38%</td>
<td>27%</td>
<td>59%</td>
</tr>
<tr>
<td>Stable</td>
<td>31%</td>
<td>24%</td>
<td>55%</td>
</tr>
<tr>
<td>Declining</td>
<td>31%</td>
<td>17%</td>
<td>18%</td>
</tr>
</tbody>
</table>

59% of executives believe the global economy is improving compared with 27% one year ago.

Q: By how much do you think/expect the local economy to grow in the next 12 months?

<table>
<thead>
<tr>
<th>Growth</th>
<th>Oct-13</th>
<th>Apr-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than 5%</td>
<td>2%</td>
<td>1%</td>
</tr>
<tr>
<td>3% - 5%</td>
<td>14%</td>
<td>3%</td>
</tr>
<tr>
<td>1% - 3%</td>
<td>30%</td>
<td>38%</td>
</tr>
<tr>
<td>Zero growth</td>
<td>26%</td>
<td>21%</td>
</tr>
<tr>
<td>Negative growth</td>
<td>18%</td>
<td>14%</td>
</tr>
</tbody>
</table>

52% of executives expect the local economy to grow in the next 12 months.
Optimism will drive dealmaking

Level of commitment to job creation underscores plans for investment
The executives’ commitment to job creation highlights that companies need to hire as they prepare for the coming wave of growth.

Continuation of the Eurozone crisis outweighs economic concerns
While political instability is believed to pose the greatest near-term risk globally, most executives from CSE countries still consider the continuation of the Eurozone crisis to be the greatest economic risk and a barrier to growth in their business.

Ongoing market volatility tempers growth and investment mandates
Only 16% of respondents have confidence in short-term market stability—which is not yet aligned with their higher confidence in other economic indicators.
Q: With regards to employment, which of the following does your organization expect to do in the next 12 months?

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduce workforce numbers</td>
<td>17%</td>
<td>22%</td>
<td>14%</td>
</tr>
<tr>
<td>Keep current workforce size</td>
<td>50%</td>
<td>46%</td>
<td>59%</td>
</tr>
<tr>
<td>Create jobs/hire talent</td>
<td>33%</td>
<td>32%</td>
<td>31%</td>
</tr>
</tbody>
</table>

Q: What do you believe to be the greatest risk to your business over the next 6-12 months?

- Continuation of the Eurozone crisis: 76%
- Increased global political instability: 15%
- Failure to manage the withdrawal of US quantitative easing: 6%
- Continued slow growth in China: 3%

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

- Economic growth: 37%
- Credit availability: 34%
- Equity valuations/Stock market outlook: 21%
- Employment growth: 19%
- Corporate earnings: 19%
- Short-term market stability: 16%
Access to capital – credit availability drives momentum

To advance their strategic imperatives, companies will take advantage of improving credit conditions.

A willingness to use leverage signals a growing confidence in the long-term economic outlook. The returning use of leverage also indicates a fundamental shift in the dealmaking environment, which was previously dominated by conservatism and the reliance on cash for financing.

Credit availability inspires growth

The vast majority of executives consider access to credit as stable or improving. Furthermore, the sentiment on improving credit is higher by 14 percentage points compared to what it was 12 months ago. This confidence, coupled with positive views on the global economy and sound economic fundamentals, will accelerate dealmaking.

Planned use of more debt and equity signals shift to more deals

The confidence to use more debt and equity (compared to April 2013) to finance deals represents a shift away from risk aversion. The use of more leverage also highlights the need for more deals to address growth mandates—and signals the return to a more active M&A environment.
Confidence to use leverage

Q: Please indicate your level of confidence in credit availability at the global level

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Declining</td>
<td>20%</td>
<td>28%</td>
<td>30%</td>
</tr>
<tr>
<td>Stable</td>
<td>38%</td>
<td>36%</td>
<td>42%</td>
</tr>
<tr>
<td>Improving</td>
<td>42%</td>
<td>36%</td>
<td>28%</td>
</tr>
</tbody>
</table>

80% of executives now consider credit either stable or improving

Q: What is the likely primary source of your company’s deal financing in the next 12 months?

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>Apr-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>27%</td>
<td>26%</td>
</tr>
<tr>
<td>Debt</td>
<td>40%</td>
<td>36%</td>
</tr>
<tr>
<td>Cash</td>
<td>33%</td>
<td>38%</td>
</tr>
</tbody>
</table>

67% of executives say they will use more debt and equity to finance deals
Growth strategies – investment intent tops Capital Agenda

Growth is now a global imperative as 41% of executives say they plan to accelerate their growth strategies over the next 12 months.

Companies have weathered a prolonged period of uncertainty. During this time, they have strengthened their balance sheets and largely optimized their capital structures. Companies are now ready to capitalize on the improving global economy and credit markets to implement their growth agendas.

Growth strategies will initially focus on the optimization of organic platforms (existing products, channels and markets). This is driven by their enhanced focus on governance and fiscal discipline. The natural progression will then be to M&A. Coupled with positive leading indicators, the greater focus on growth points will lead to a return of increased M&A activity.

Focus on growth

Over the next 12 months, growth is the primary focus for 41% of companies. Continued operational efficiency and cost control measures have largely eliminated concerns about stability and survival.

Excess cash is used to fund growth and retire debt

Almost 50% of companies plan to use excess cash to fund growth—starting with lower risk organic strategies. They will also use excess cash to pay down debt, which is one of the remaining ways to optimize their capital structure.

Organic growth strategies will center on core products and existing markets

To address their need for growth, companies will initially focus on organic platforms: known products, channels and markets. This strategy allows them to pursue growth while maintaining financial discipline and governance objectives. As they exhaust lower risk organic options, companies will pursue higher-risk organic strategies: new products, channels and geographies.
Growth is the priority

**Q: Which statement best describes your organization’s focus over the next 12 months?**

<table>
<thead>
<tr>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>5%</td>
<td>15%</td>
<td>39%</td>
</tr>
<tr>
<td>3%</td>
<td>36%</td>
<td>25%</td>
</tr>
<tr>
<td>25%</td>
<td>47%</td>
<td></td>
</tr>
</tbody>
</table>

- Survival
- Maintain stability
- Cost reduction and operational efficiency
- Growth

**Q: If your company has excess cash to deploy, which of the following will be your company’s focus over the next 12 months?**

<table>
<thead>
<tr>
<th>Invest in growth</th>
<th>Return to stakeholders</th>
<th>Higher risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organic growth</td>
<td>Pay down debt</td>
<td>Increase R&amp;D/product introductions</td>
</tr>
<tr>
<td>(e.g. investing in products, capex, talent retention, R&amp;D)</td>
<td>Paying dividends</td>
<td>Changing mix of existing products &amp; services</td>
</tr>
<tr>
<td>Inorganic growth</td>
<td>Buy back stock</td>
<td>Exploiting technology to develop new markets/products</td>
</tr>
<tr>
<td>(e.g. acquisitions, alliances and JVs)</td>
<td></td>
<td>Investing in new geographies/markets</td>
</tr>
</tbody>
</table>

**Q: What is the primary focus of your company’s organic growth over the next 12 months?**

**Lower risk**
- More rigorous focus on core products/existing markets
- New sales channels

**Higher risk**
- Exploiting technology to develop new markets/products
- Investing in new geographies/markets

- Oct-13: 15% 14%
- Apr-13: 8% 8%
- Oct-12: 5% 11%

- Oct-13: 16% 16%
- Apr-13: 11% 11%
- Oct-12: 3% 6%

- Oct-13: 31% 31%
- Apr-13: 21% 15%
- Oct-12: 16% 8%

- Oct-13: 3% 6%
- Apr-13: 16% 6%
- Oct-12: 21% 16%

- Oct-13: 33% 33%
- Apr-13: 32% 32%
- Oct-12: 31% 31%

41% of executives say their primary focus is on growth over the next 12 months.

45% of companies with excess cash plan to invest in growth over the next 12 months.

43% of executives say their organic growth will focus on core products and existing markets.
Investment tops companies’ Capital Agenda

**Q:** Which statement best describes your organization’s focus over the next 12 months?

**Raising:** A company’s ability to raise capital is integral to achieving its growth imperatives and financial well-being. And with credit increasingly available and more attractive, companies now indicate a desire to take on more leverage, which signals that more dealmaking will be done.

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raising</td>
<td>11%</td>
<td>15%</td>
<td>22%</td>
</tr>
</tbody>
</table>

**Preserving:** A company’s ability to access liquidity, control costs and engage with key stakeholders is essential to preserving capital amid shifting market forces. Since most companies were forced to focus on preservation in order to survive, they are now able to concentrate on other areas of their Capital Agenda.

<table>
<thead>
<tr>
<th></th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preserving</td>
<td>4%</td>
<td>5%</td>
<td>19%</td>
</tr>
</tbody>
</table>
Capital Agendas

**Investing:** Executives’ sentiment indicates an investment climate is imminent, and as required levels of growth and returns increase, companies will look to M&A. Improving economic fundamentals will also enable more deal-powered growth.

<table>
<thead>
<tr>
<th></th>
<th>October-13</th>
<th>April-13</th>
<th>October-12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>48%</td>
<td>50%</td>
<td>33%</td>
</tr>
</tbody>
</table>

**Optimizing:** Companies continue to employ a disciplined approach to capital optimization with an enhanced focus on governance and fiscal rigor. And with capital structures largely optimized, today they are primarily focused on refinancing to retire maturing debt and position themselves for more leverage.

<table>
<thead>
<tr>
<th></th>
<th>October-13</th>
<th>April-13</th>
<th>October-12</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>37%</td>
<td>30%</td>
<td>26%</td>
</tr>
</tbody>
</table>
Mergers & acquisitions – more but smaller deals expected

A shift of focus on smaller deals is now visible— as expectations for deals below $51m have almost doubled in the last 12 months.

These expectations, along with the stable deal volumes, are clear indicators that a more niche dealing environment is on the horizon. The anticipated widening of valuation gaps can be seen as a precursor to more dealmaking. As companies begin to act on their intentions for dealmaking and their imperative to grow, it will trigger deals of varying size across the CSE marketplace.

Local deal volumes expected to remain stable

In CSE, 51% of executives expect deal volumes to remain stable over the next 12 months and about 36% of the respondents expect deal volumes to improve. Deal volumes resonate from the alignment of core fundamentals: positive economic sentiment, enhanced credit availability, the imperative for growth and the expectation to create jobs.

M&A expectations

With core fundamentals in place to support M&A, one-quarter of companies will pursue acquisitions in the next 12 months.

Clear focus on smaller deals

Executives who expressed the intent to engage in smaller transactions (< $50m) increased significantly to 63% compared to 36% one year ago and represented the majority of expected deals. Those focused on market-moving deals ($501m to $1b range) dropped by 10 percentage points to 4%. These are shifts that indicate a more niche dealmaking environment on the horizon.
A new deal environment

**Q:** What is your expectation for local M&A/deal volumes in the next 12 months?

<table>
<thead>
<tr>
<th></th>
<th>Improving</th>
<th>Remain the same</th>
<th>Declining</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-13</td>
<td>36%</td>
<td>51%</td>
<td>13%</td>
</tr>
</tbody>
</table>

**Q:** What is your expectation to pursue an acquisition and your level of confidence in the following at the global level?

<table>
<thead>
<tr>
<th>Expectations to pursue an acquisition</th>
<th>Oct-13</th>
<th>Apr-13</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>48%</td>
<td>13%</td>
<td>38%</td>
</tr>
<tr>
<td>20%</td>
<td>40%</td>
<td>28%</td>
<td>25%</td>
</tr>
<tr>
<td>30%</td>
<td>36%</td>
<td>39%</td>
<td>61%</td>
</tr>
<tr>
<td>40%</td>
<td>38%</td>
<td>57%</td>
<td></td>
</tr>
<tr>
<td>50%</td>
<td>21%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Q:** What is the expected deal size?

<table>
<thead>
<tr>
<th></th>
<th>US$0 - US$50m</th>
<th>US$51m - US$500m</th>
<th>US$501m - US$1bn</th>
<th>Over US$1bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct-13</td>
<td>63%</td>
<td>33%</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Apr-13</td>
<td>61%</td>
<td>35%</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Oct-12</td>
<td>36%</td>
<td>50%</td>
<td>14%</td>
<td></td>
</tr>
</tbody>
</table>

**87%** of executives expect local M&A/deal volumes to improve or remain the same.

**25%** of companies are expected to pursue acquisitions in the next 12 months.

**63%** of executives expect to make deals of a value of less than US $50m.
Mergers & acquisitions, cont.

Top cross-border investment

Q: Which are the top 5 countries (outside your local market) in which your company is most likely to invest?

Top 5 investment destinations

1. Russia
2. Germany
3. Brazil
4. Romania
5. [Additional destinations listed in the text]
The interdependency between developed and emerging economies continues to increase. The emerging markets, both BRIC (Brazil, Russia, India and China) and non-BRIC, are of growing interest to dealmakers, and allow for portfolio diversification.

Emerging markets are also expected to invest more in mature economies as well as other emerging markets prospectively, as they secure the necessary capital and seize the opportunity to drive growth through acquisitions.

Top 5 destinations:
1. Russia
2. Germany
3. Brazil
4. Romania
5. China
Increased dealmaking locally activity in the mature markets

Acquisition capital will be allocated to both emerging and mature markets
Both emerging and mature markets are expected to draw almost equal portions of acquisition capital over the next 12 months.

Emerging market interest remains strong
Over the last 12 months, 29% of executives indicate they have placed greater focus on investing in the BRIC (17%) and non-BRIC (12%) emerging markets as they search for new strategic opportunities. However, the mature markets continue to be an important investment destination.

M&A in slowing-growth emerging markets requires more transaction rigor
While certain emerging markets have experienced slowing growth, executives stay largely optimistic about the opportunities they present, provided greater rigor is applied to dealmaking. Unlike their mature counterparts, emerging markets continue to rapidly evolve and transaction risk must be managed.
will be driven by renewed

Q: How do you expect to allocate acquisition capital in the next 12 months?

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Mature market</th>
<th>Emerging market - BRIC</th>
<th>Emerging market - non-BRIC</th>
</tr>
</thead>
<tbody>
<tr>
<td>75% - 100%</td>
<td>8%</td>
<td>16%</td>
<td>8%</td>
</tr>
<tr>
<td>50% - 74.9%</td>
<td>16%</td>
<td>5%</td>
<td>13%</td>
</tr>
<tr>
<td>25% - 49.9%</td>
<td>5%</td>
<td>15%</td>
<td>13%</td>
</tr>
<tr>
<td>Less than 25%</td>
<td>61%</td>
<td>54%</td>
<td>62%</td>
</tr>
</tbody>
</table>

Q: How has your sentiment towards investing in emerging markets changed versus a year ago?

- Greater focus - emerging markets: 29%
- Stayed the same: 60%
- Less focus today - emerging markets: 11%

Q: Which statement best describes your approach to M&A in those emerging markets which are experiencing slowing growth?

- Optimistic about opportunities and have not changed the approach to assessing deals in emerging markets: 8% Oct-13, 14% Apr-13
- Optimistic but will apply further rigor when assessing deal opportunities in emerging markets: 14% Oct-13, 35% Apr-13
- Less optimistic and are reconsidering the emerging markets strategy: 21% Oct-13, 19% Apr-13
- Less optimistic and have already turned attention more toward developed market deal opportunities: 6% Oct-13, 9% Apr-13
- Have discontinued the emerging markets strategy for now: 30% Oct-13, 19% Apr-13

61% of executives expect to allocate less than 25% of their acquisition capital to mature markets in the next 12 months.

29% of executives place a greater focus on emerging markets today versus 12 months ago.

35% of executives remain optimistic but will apply further rigor in the emerging markets.
Valuation gaps expected to widen

There is a natural divergence between buyers’ and sellers’ expectations on pricing. 22% of executives expect valuation gaps to widen over the next 12 months vs. 14% six months ago. This widening gap results as buyers and sellers adjust their expectations at different rates.
22% of executives expect valuation gaps to widen compared with 14% six months ago.

Pricing gaps aside, the market fundamentals are falling into place to support a suitable environment for transactions.
Divestments enable corporate objectives

Recognized for their strategic value, divestments are an effective tool to address a variety of corporate objectives. Companies will continue to shed non-strategic and underperforming assets as they optimize their capital structures and focus on their core business. Fewer plan to use divestments to raise capital since credit is now more readily available.

Business unit sales are the preferred structure for divestments

At 66%, sales of non-core business units will dominate the divestment environment, as companies continue to strengthen their corporate structure.

About this survey

EY’s Capital Confidence Barometer is a regular survey of senior executives from large companies around the world conducted by the Economist Intelligence Unit (EIU).

The respondent community is comprised of an independent EIU panel of senior executives and selected EY clients and contacts.

Our 9th Barometer provides a 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.
to driving strategic value

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

- Focus on core assets: 40% (Oct-13), 43% (Apr-13), 60% (Oct-12)
- Enhance shareholder value: 26% (Oct-13), 24% (Apr-13), 30% (Oct-12)
- Shed underperforming business unit: 26% (Oct-13), 26% (Apr-13), 26% (Oct-12)
- Raise cash to compensate for underperformance of aggregate business: 20% (Oct-13), 17% (Apr-13), 40% (Oct-12)
- Fund inorganic/M&A growth plans: 17% (Oct-13), 28% (Apr-13), 10% (Oct-12)

**Q: What form do you expect your divestments to take?**

- Sale of business unit: 66% (Oct-13)
- Sale of entire business: 14% (Oct-13)
- Spin/IPO of business unit: 11% (Oct-13)
- Contribution of business unit to joint venture: 9% (Oct-13)

**Profile of respondents**

- EIU panel of more than 1,600 executives surveyed in September 2013
- 186 executives from CSE
- Companies from 72 countries
- Executives from more than 20 industry sectors
- 792 CEO, CFO and other C-level executives
- More than 900 companies would qualify for the Fortune 1000 based on revenues
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