



Why capital matters

Building competitive advantage
in uncertain times

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About this study

Why capital matters is issued as businesses the world over seek to come to terms with the full extent of the financial crisis and the uncertain recovery that lies ahead.

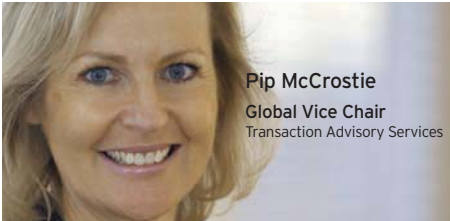
Its objectives are to gauge corporate confidence in the economic outlook, to understand boardroom priorities in the next 12 months and to identify the emerging practices that will distinguish those businesses that will seize the initiative and build competitive advantage as the global economy continues to evolve.

The study contains the inaugural findings of Ernst & Young's *Capital confidence barometer*, a survey of senior executives from large companies around the world and across industry sectors conducted by the Economist Intelligence Unit (EIU), interpreted and informed by a global panel of Ernst & Young partners.

The *Capital confidence barometer* will be rerun throughout 2010 to gauge shifts in boardroom sentiment, confidence, focus and activity as the dynamics of the post-recession environment become more clear.

Profile of respondents

- ▶ EIU panel of 490 senior executives surveyed in September and October 2009
- ▶ Companies from 32 countries including the US, Australia, UK, Germany, India, Russia, Japan, France and China
- ▶ Cross section of respondents from 21 industries including consumer products, technology, power and utilities, life sciences, financial services, telecommunications, oil and gas, manufacturing, professional services, real estate, media and entertainment, automotive, aerospace and defense, insurance, mining and metals, retail, logistics and distribution
- ▶ 275 CEO, CFO and other C-level respondents
- ▶ 243 companies with revenues above US\$1b
- ▶ 106 companies that would qualify for *Fortune* Global 500 based on revenues



I am delighted to introduce you to *Why capital matters* – the first global study of its kind that measures corporate confidence at a time of prolonged market uncertainty.

Characterized by changing demand patterns, capital scarcity and the fiscal fallout of government stimulus packages, the recovery may mean no real economic growth beyond inflation. In this environment, boards will be challenged to deliver the financial returns needed to satisfy investors, while generating cash to fund the ongoing needs of their business.

This study provides a unique insight into what is now the most pressing issue in the boardroom – capital. The inaugural Ernst & Young *Capital confidence barometer* yields high-quality views from a wide range of senior executives across a variety of industries. Our findings underline the fact that although capital has always been a high priority, how organizations manage their capital agenda today will define their competitive position tomorrow.

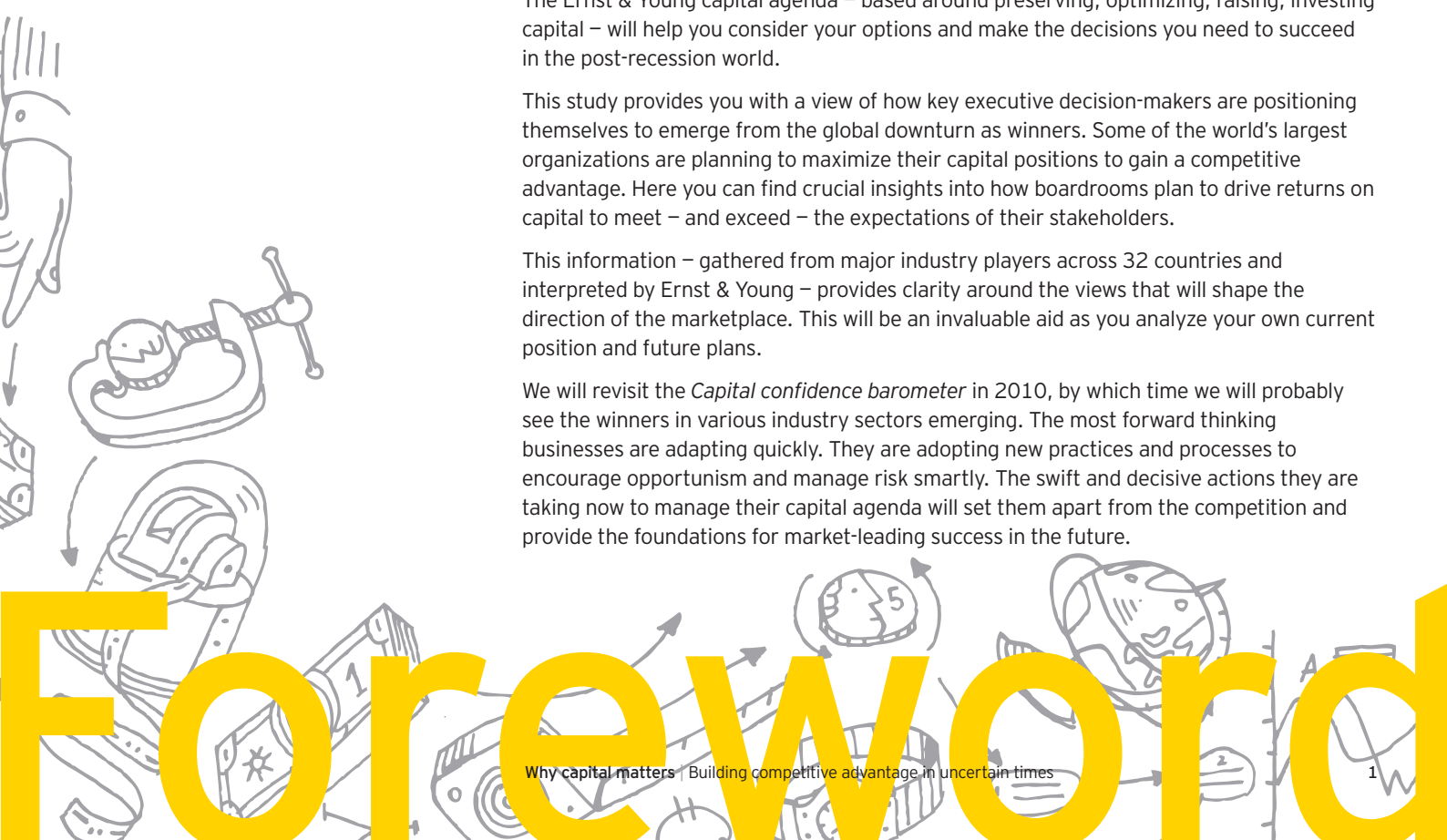
The fundamental changes we have seen in the market have transformed the corporate relationship with capital. It is no longer cheap and it is not readily available – and this will be the “new normal” for the foreseeable future. Boardrooms must now plan using a new set of assumptions. For instance, there may be no refinance options as debt payments come due and breathing space may contract further as lenders continue to tighten credit. These tough new realities of capital will force some executives to seriously consider a strategic review.

A strong capital agenda now needs to be at the heart of all strategic decisions in the boardroom. Should you embark on an operational restructuring? Should you divest? Should you acquire opportunistically? Different options will suit different needs but one thing is clear – doing nothing and trying to ride out the storm is not a strategy for success. The Ernst & Young capital agenda – based around preserving, optimizing, raising, investing capital – will help you consider your options and make the decisions you need to succeed in the post-recession world.

This study provides you with a view of how key executive decision-makers are positioning themselves to emerge from the global downturn as winners. Some of the world's largest organizations are planning to maximize their capital positions to gain a competitive advantage. Here you can find crucial insights into how boardrooms plan to drive returns on capital to meet – and exceed – the expectations of their stakeholders.

This information – gathered from major industry players across 32 countries and interpreted by Ernst & Young – provides clarity around the views that will shape the direction of the marketplace. This will be an invaluable aid as you analyze your own current position and future plans.

We will revisit the *Capital confidence barometer* in 2010, by which time we will probably see the winners in various industry sectors emerging. The most forward thinking businesses are adapting quickly. They are adopting new practices and processes to encourage opportunism and manage risk smartly. The swift and decisive actions they are taking now to manage their capital agenda will set them apart from the competition and provide the foundations for market-leading success in the future.





Executive summary

Capital matters more today than ever before. Whatever your view on the recovery, uncertainty is the only certainty there is. Those who have the organizational flexibility to adapt and respond as the market changes will be able to exploit opportunities – those who don't will miss them and weaken their competitive position.

The “new normal” of continuing uncertainty, weaker demand, margin erosion, scarcity of capital and increased risk aversion in strategic decision-making has narrowed the margins for error in capital allocation. Many companies feel inclined to hoard cash and be reactive, but winning companies will avoid the temptation for inertia, and use their capital to seize opportunities.

Findings from our inaugural *Capital confidence barometer* reveal a resounding sense that the business landscape has changed in fundamental ways that create both risk and opportunity. It also reveals an emerging polarization of businesses into those gearing up to capitalize on acquisition growth opportunities and those that feel constrained, stifled and unprepared in their ability to do so.

The barometer indicates that the next 12 months will see the rise of a few winners in each industry – those who adapt their capital agenda to better manage uncertainty and exploit opportunity.

“It is not the strongest of the species that survives, nor the most intelligent. It is the one that is the most adaptable to change.”

Charles Darwin

Leading businesses are adopting a range of disciplines in five key areas to build competitive advantage:

1. **Preserving capital** – Reshaping the operational and capital base to reflect the risks and realities of a prolonged downturn
2. **Optimizing capital** – Driving cash and working capital, and managing the portfolio of core and non-core assets to accelerate return on capital
3. **Raising capital** – Assessing future capital requirements and determining how funding sources can be diversified to increase optionality
4. **Investing capital** – Strengthening investment appraisal and execution methods so that opportunities can be realized while managing increased risk
5. **Enabling the capital agenda** – Upgrading planning, forecasting, performance reporting and governance processes to sharpen decision-making speed and effectiveness

This may feel like a “back-to-basics” approach and in many ways it is – these are good financial management disciplines after all. However in less challenging times they have been allowed, in many businesses, to slip.

Our barometer indicates that while most companies are focused on at least part of this agenda, many are finding limitations in their systems, processes and capabilities that prevent them from managing the agenda with the rigor and foresight demanded by the new environment.

We believe those who develop their capabilities to master this agenda will build competitive advantage by:

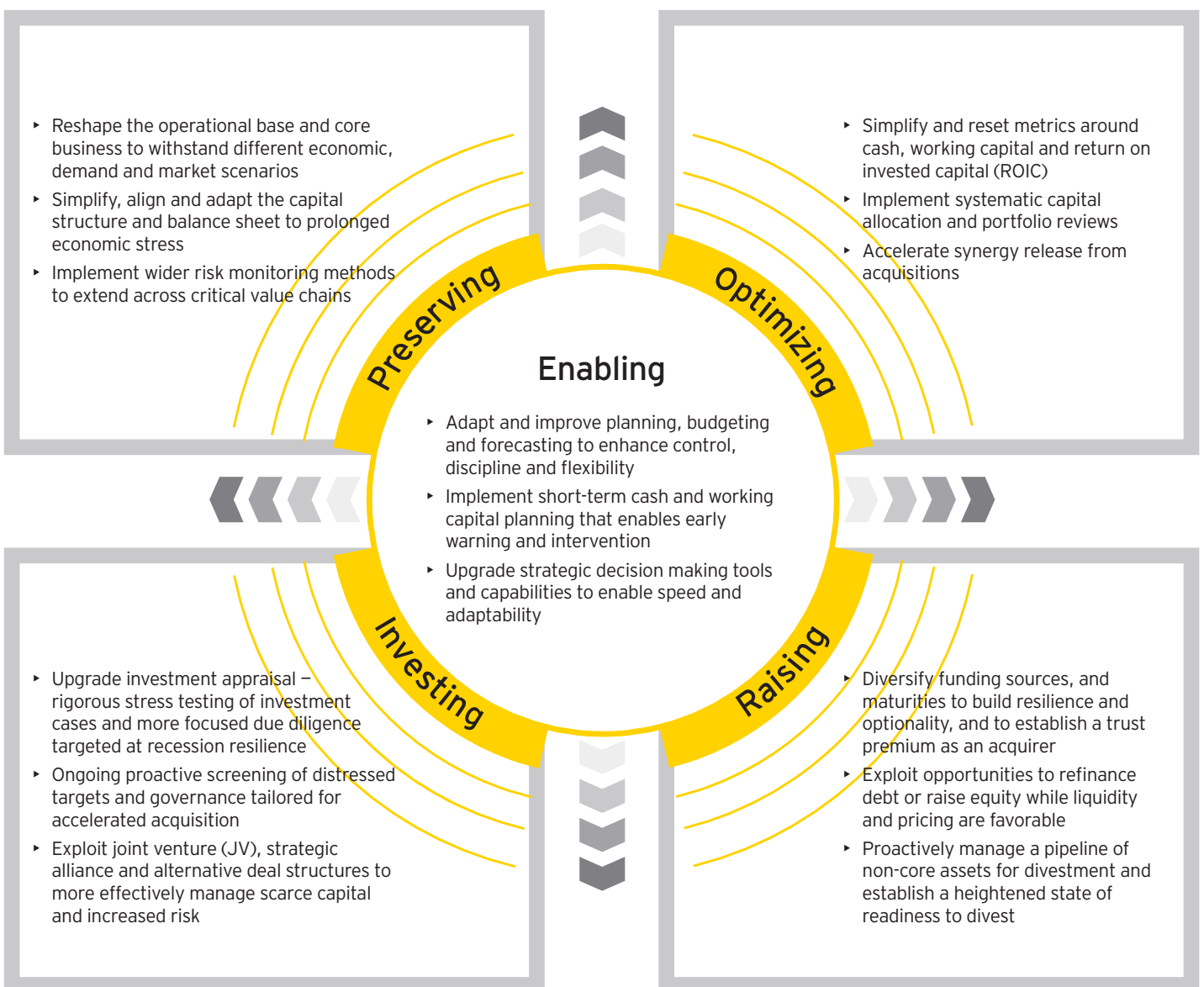
- ▶ Increasing and maintaining investor confidence
- ▶ Winning the competition for scarce capital
- ▶ Anticipating and adapting to market conditions as they change
- ▶ Seizing acquisition and other growth opportunities that others are unable to

Those who fail to implement a more rigorous approach increase their vulnerability as others in their industry move ahead.

This is not an agenda that can wait.



Leading businesses are adopting a range of practices across the five key areas of the capital agenda to build competitive advantage





The outlook for business

A difficult road ahead

While there are still uncertainties over the exact speed, shape and size of any upturn, we believe a swift, strong global recovery is not among the likely scenarios.

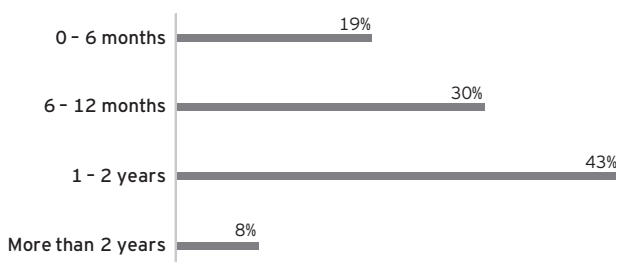
We believe that volatility and uncertainty will continue to be major features of the landscape for at least the next two years and that many factors caused by the downturn will continue to impede, stifle and check the recovery's progress. In particular, governments have spent US\$10.8t on bailout and stimulus packages, the unwinding of which will impact economies across the world for many years to come and create the risk of further threats to any fragile recovery.

This note of caution is echoed by our barometer with over 50% of respondents expecting the financial crisis and downturn to persist at least more than one year in their own industry, and 70% of companies expecting the downturn in the broader economy to persist beyond the next 12 months. Twenty-eight percent believe it will continue for more than two years.

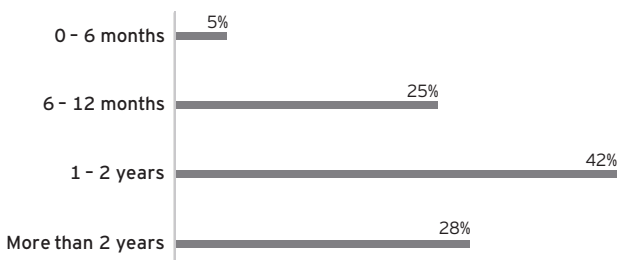
Furthermore, 53% of respondents believe that financing conditions will not return to mid-2007 levels for at least another three years, with 19% believing it will be over five years or may never return to this level.



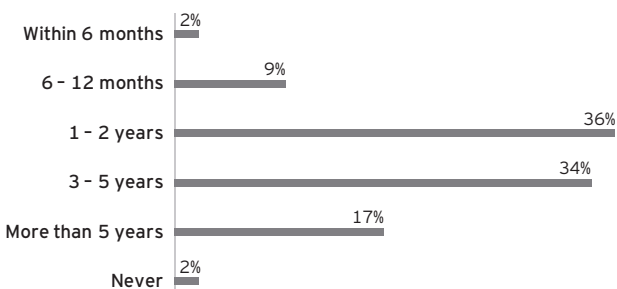
**How long does your organization expect the financial crisis and resultant downturn to persist ...
... in your industry?**



... in the broader economy?



When do you think the availability of finance to fund major acquisitions and (or) capital projects will return to mid-2007 levels?

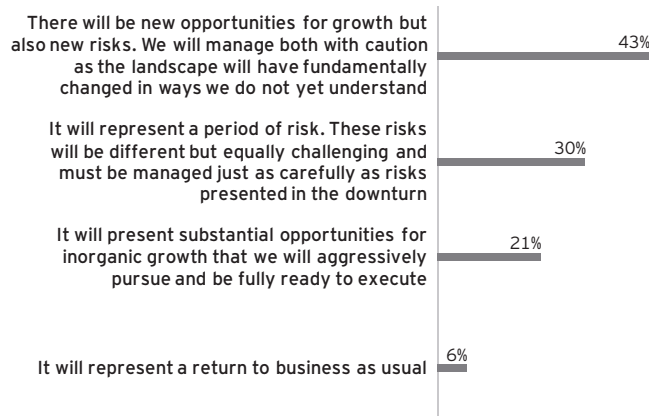


No return to “business as usual” – new risks, new opportunities

Amid the uncertainty, 94% of our surveyed executives accepted that there will be no return to “business as usual” – the landscape has fundamentally changed in ways that they don’t yet fully understand.

The next two years will present a wide range of unfamiliar and unprecedented challenges and risks for business. Thirty percent see the environment as one more of risk than opportunity, while 43% see both risk and opportunity. Perhaps the most striking finding, however, is the 21% of companies that anticipate substantial opportunities for inorganic growth. The fact that they also state a readiness to execute should sound a warning shot to those less prepared who may be vulnerable.

Which of the following statements best describes your organization’s views on economic recovery?



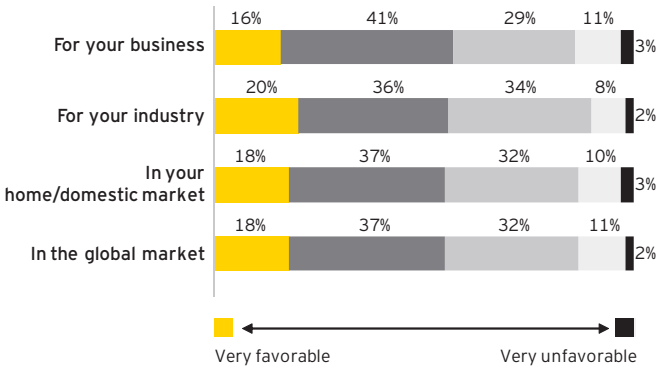


Outlook for mergers and acquisitions (M&A) improving but sellers remain cautious

As businesses size up on which side of this fence they sit, there is perhaps surprisingly a growing sense of anticipation about M&A activity with 57% of respondents classifying the M&A environment as favorable for their business. Twenty-five percent of businesses are likely or highly likely to acquire in the next six months, rising to 33% in the next 12 months and 41% over the next 12 to 24 months.

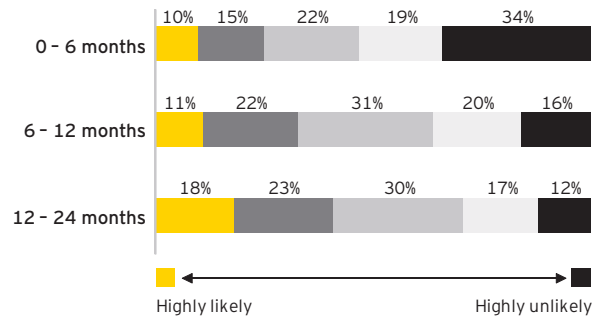
In contrast, there is less confidence in divestments, with only 18% expecting to divest in the next six months and only 21% in the next 12 to 24 months indicating that growth in M&A will be dependent on sellers further revising their expectations on pricing.

Overall, how would you rate the outlook for M&A activity for the next 12 months?

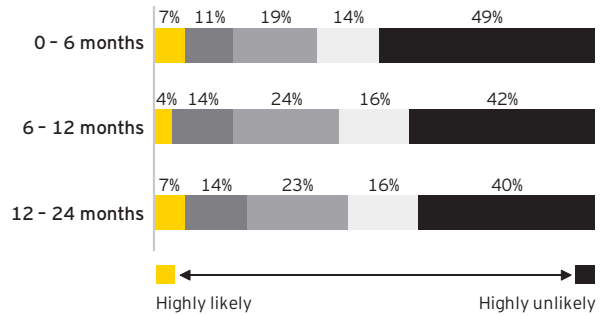


How likely is your company to execute transactions in the following time periods:

...acquisitions?



...divestments?

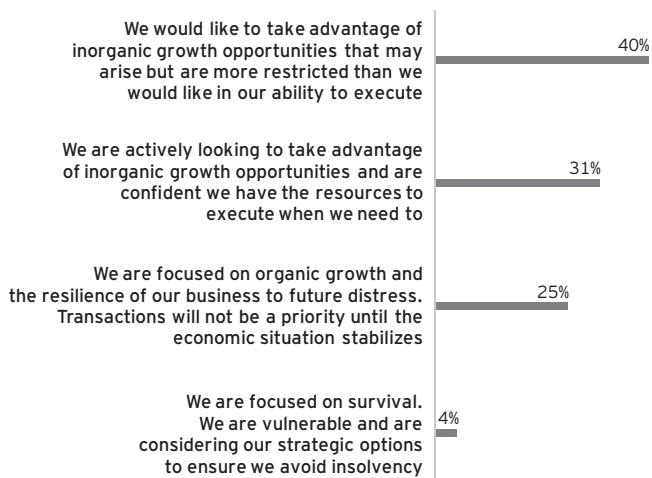




Many feel restricted

Despite the seemingly favorable outlook for M&A, it is clear from our barometer that not all companies will be able to realize acquisition opportunities. While 71% of businesses are interested in pursuing inorganic growth opportunities in the next 6 months, over half of those companies feel constrained or restricted, creating a significant advantage for the 31% of companies who do have the resources to execute. This implies that a sizeable proportion of businesses will be able to acquire distressed assets with limited competition for at least the next six months.

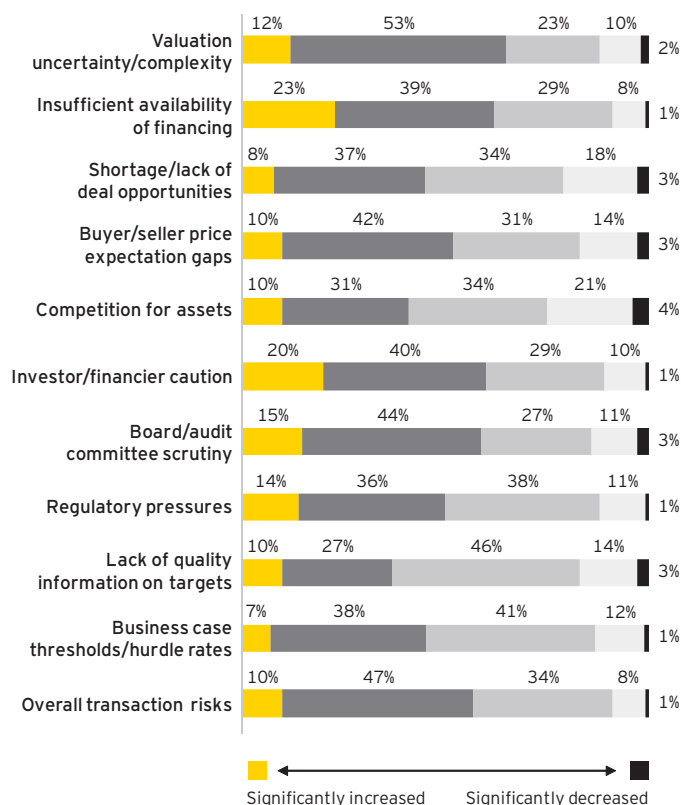
Which statement best describes your organization's focus over the next six months?



There are several notable restrictions to deal doing highlighted by the barometer – it is clear that traditional approaches will no longer suffice for those gearing up to transact.

Valuation uncertainty and complexity (65%), insufficient financing (62%), investor caution (60%), board scrutiny (59%) and increased transaction risk (57%) all create potential obstacles and reflect the challenges faced by the 40% of businesses who would like to pursue opportunities but feel restricted.

Which of the following potential obstacles to future transactions do you expect have increased as a result of the economic downturn?



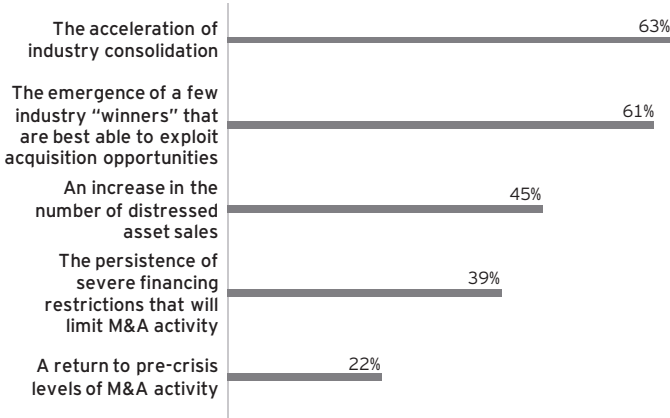


Conditions for polarization

History suggests that the period following a downturn can polarize markets with some companies struggling to compete with those that are moving ahead. This can drive an increase in the number of corporate failures despite improving economic conditions.

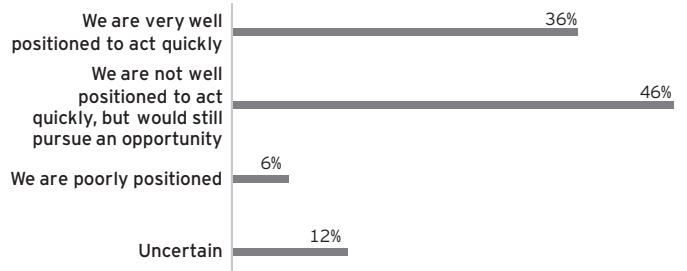
The barometer results suggest that this downturn will be no different. Sixty-three percent are expecting to see an acceleration in industry consolidation in the next 12 months, while 61% of our respondents expect the downturn to reveal the emergence of a few industry winners best able to exploit acquisition opportunities.

Which of the following best characterizes what you expect to see in your sector in the next 12 months as a result of the crisis?



Forty-five percent of executives expect to see an increase in the number of distressed asset sales in the next 12 months. The winners will likely be those best equipped to capitalize on these opportunities. This requires an ability to react at very short notice as distressed assets come to market – advanced preparation is everything. Some 36% of companies believe they are poised to exploit such opportunities, while the rest seem set to miss out.

How well positioned is your company (in terms of finance and decision-making) to execute an acquisition at short notice (i.e., less than 30 days) should a good opportunity present itself?



Driving the capital agenda to build competitive advantage

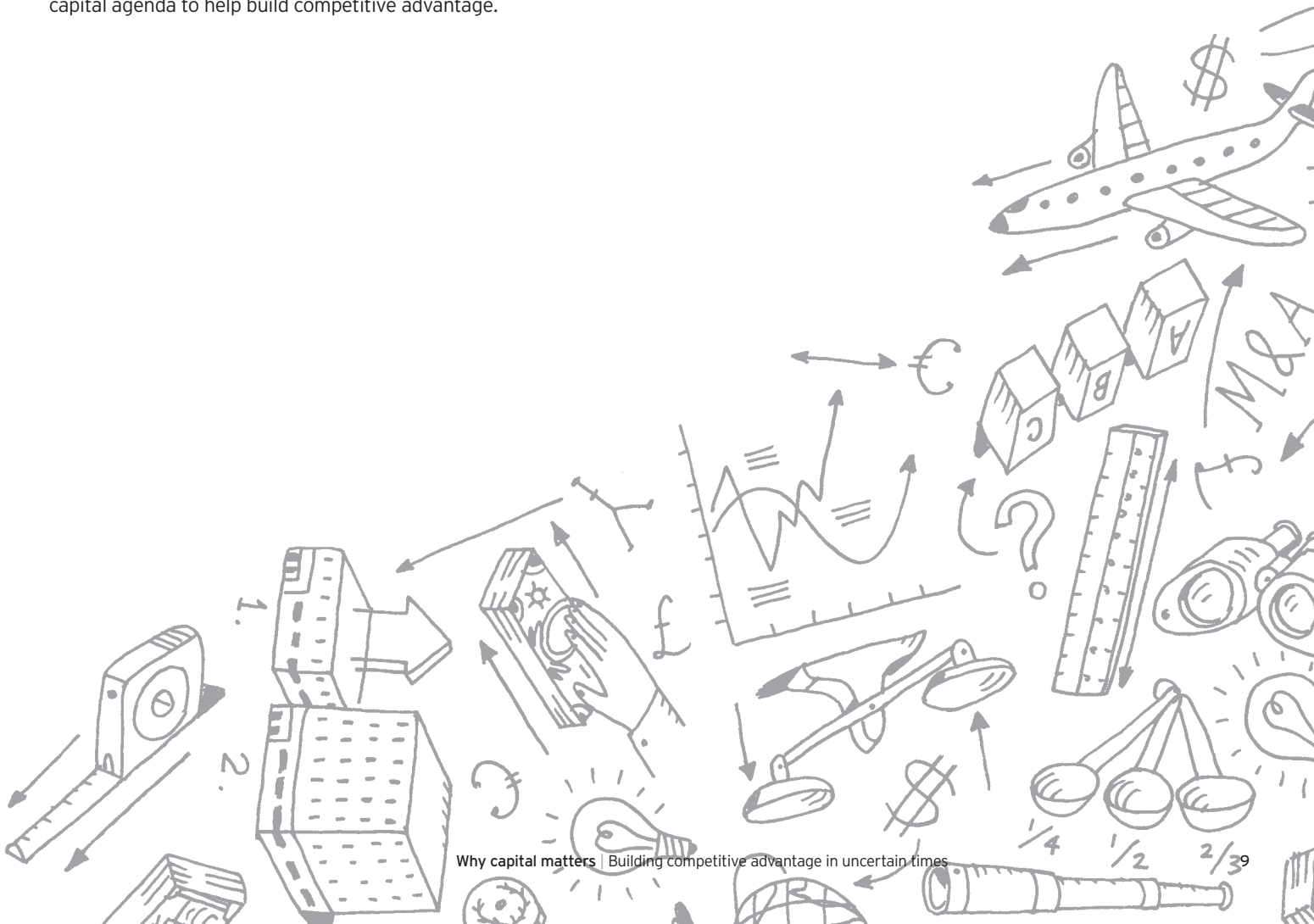
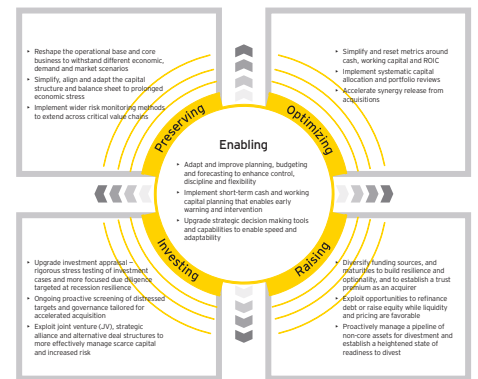
The barometer indicates that leading boards are focused on a disciplined capital agenda as the enabler for building competitive advantage. This agenda is being driven to:

- ▶ Increase operational fitness and resilience around core business operations
- ▶ Increase organizational flexibility and agility to respond as growth opportunities arise

A range of practices and disciplines are emerging in how these leading companies **preserve, optimize, raise** and **invest** capital and in how they **enable** more effective decision-making across the capital agenda.

We believe these practices will, over time, become accepted business norms. For at least the next 12 months, they should represent a powerful source of competitive advantage for those who implement them effectively.

The *Capital confidence barometer* informs the key areas of focus and concern for businesses. Using this, and based on our own experience of working with leading companies in these areas, we have defined the key actions being taken in each area of the capital agenda to help build competitive advantage.



Preserving capital

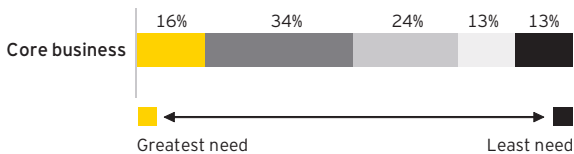
Boards are focused on strengthening their core and rightsizing the operational and capital base to establish resilience to a prolonged period of uncertainty

Focus on resilience of the core business

Resilience of core operations is important at any time. In times of crisis and faced with prolonged downturn, it represents the difference between success and failure.

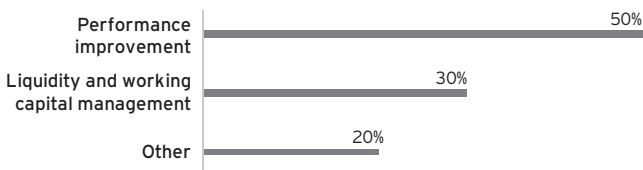
In this context, 50% of our respondents are focused on restructuring their core business. It will be critical for boards to demonstrate to current and future investors that decisive action has been taken in this area rather than unsustainable "quick fix" solutions.

To what extent do you anticipate the need to restructure:



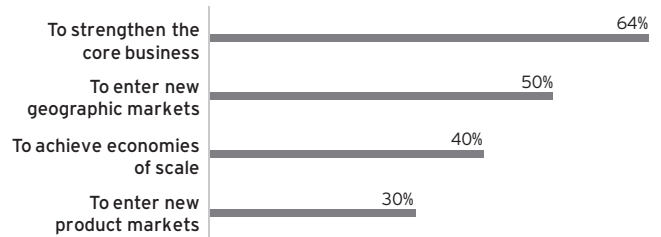
Restructuring initiatives are targeted to drive performance improvement and improved cash flow and liquidity. Building a "story" of stable and improving cash flows and improving profitability will be differentiating features in any future competition for financing – an intensification of which is to be expected in 2010 as government stimulus packages unwind.

What will be your main priority in restructuring?



Further evidence of the resolute focus on strengthening the core is provided by the 64% of companies who cited this as the primary reason for considering acquisitions, with 40% acquiring to realize economies of scale. Focus on the core was also cited by 45% as the primary reason for considering divestments signaling a potential wave of non-core disposals as restructuring progresses through 2010.

What is your current principal rationale for considering ...acquisitions?



...divestments?

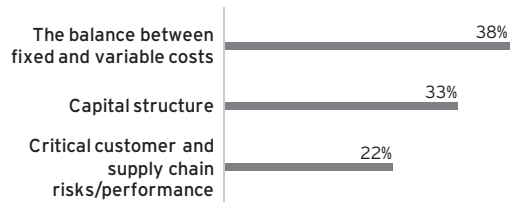


Rightsizing the operational and capital base

Companies are looking to reshape their operational and capital base to reduce rigidity, better manage cost and to enhance the ability to flex and adapt as the market changes. Heightened economic risk is also forcing boards to consider issues that could arise in the value chain outside of its control such as with key vendors and customers.

The barometer reveals a key focus for 38% of businesses on managing the balance between fixed and variable costs so as to better enable scaling of operations, up or down, at short notice to protect profitability. A third are expecting their capital structure to receive increased attention over the next 12 months – debt-to-equity ratios being critical among the key considerations with interest burdens impacting profitability for many. Value chain risks around critical customers and vendors are an area of focus for 22% of companies.

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



Building competitive advantage

Leading businesses are focused on three key areas to better preserve capital

1 Reshape the operational base and core business to withstand different economic, demand and market scenarios

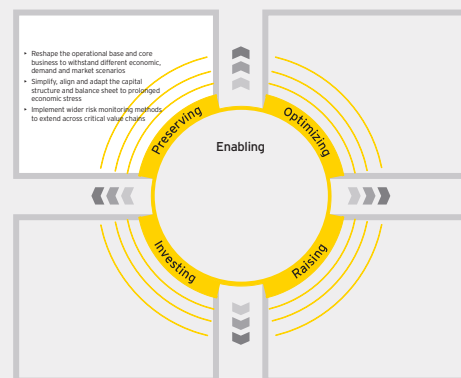
- ▶ Boards must first establish a realistic view of sustainable financial performance. This starts with a review of each market, the macro-economic outlook in each of its territories and each entity's trading prospects. Against this baseline view of the business, boards can properly assess prospects for generating expected financial returns while also generating sufficient cash to fund capital investment and service debt. This baseline can then be used to define and prioritize operational restructuring programs.

2 Simplify, align and adapt the capital structure and balance sheet to prolonged economic stress

- ▶ Determine the optimum capital structure in light of medium-term strategic objectives. Debt-to-equity ratios must be challenged with a view to reducing future interest burdens, particularly as the underlying tax profile may have changed leading to unexpected tax costs. Risk/reward implications of different capital mixes should be considered, as should the ability to service debt alongside the need to invest in the business, and the need to retain a cushion to weather future economic shock.
- ▶ Increase the level of stakeholder engagement and transparency around capital structures and future plans for modification.

3 Implement wider risk monitoring methods to extend across critical value chains

- ▶ Leading companies are placing greater emphasis on measuring and monitoring vendor and customer risk by paying particular attention to unique risks imposed by customer and vendor geographic markets.
- ▶ Key activities include a robust review of customer credit policies and compliance. Vendor contracts may need to be amended or renegotiated to include performance metrics, rewards and penalties. More complete mitigating strategies including active negotiation of alternative supply agreements or non-recourse receivable factoring arrangements may also be advised.





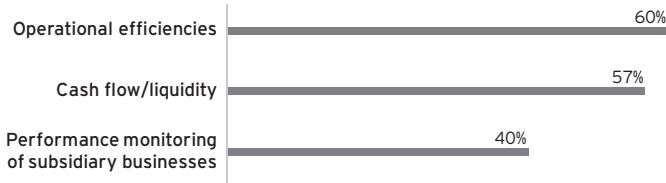
Optimizing capital

Driving operational fitness, cash and working capital, strengthening portfolio management and accelerating speed to value from acquisitions are all seen as key to optimizing capital

Relentless pursuit of operational fitness

The downturn has forced businesses to look hard at their operational fitness. Our barometer suggests an unrelenting focus on driving operational efficiency (60%) and improved cash flow and liquidity (57%). Companies appear committed to driving new disciplines into their organizations that, in less challenging times, may have been allowed to slip.

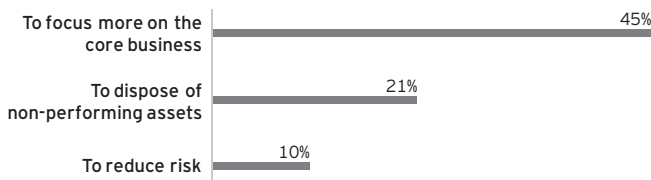
Which of the following aspects of your business do you expect will receive increased attention over the next 12 months, as a result of the economic situation?



Portfolio management to ensure optimum capital allocation

Boards are looking to establish a tighter grip on their portfolio of businesses with 40% looking to more closely monitor the performance of subsidiaries. More active portfolio management enables early intervention when performance begins to drop. It also establishes a means by which priorities can be set for restructuring and by which underperforming assets can be identified for divestment. This will be an important enabler for the 45% of companies looking to divest assets to focus more on the core business as well as to the 21% of companies who plan to dispose non-performing assets.

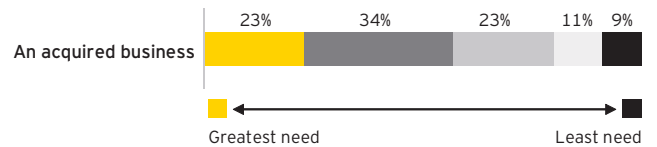
If you are considering asset sales/divestments, what are your main reasons for doing so?



Realizing value of acquired businesses

The barometer highlights the importance of effective acquisition integration. Never has speed to value been more important than now with cautious investors looking closely to ensure what was promised in investment cases gets delivered. Fifty-seven percent of companies are focused on restructuring acquired businesses – we believe this reflects a range of factors including addressing historical shortfalls in driving acquisition synergies and the need to reshape businesses acquired before the downturn. Whatever the reason, there is an increasingly intense spotlight on value delivered from acquisitions.

To what extent do you anticipate the need to restructure:



Building competitive advantage

Leading companies are focused on three key areas to optimize capital deployed

1 Simplify and reset metrics around cash, working capital and ROIC

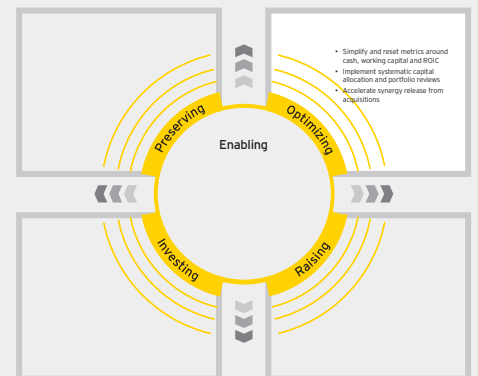
- ▶ Leading companies are adopting simpler but more appropriate sets of key performance indicators (KPIs) and resetting performance targets with their operations based on these metrics.
- ▶ Cash conversion and working capital measures are crucial to driving a stronger cash culture, and a greater focus is being placed on ROI and ROIC metrics.
- ▶ Companies are more closely monitoring the risks to cash under different business scenarios. This may require investment in improved risk management processes and business modeling capabilities so finance providers can be assured of the stability and resilience of future cash flows to further economic stress.

2 Implement systematic capital allocation and portfolio reviews

- ▶ Key to exploiting future opportunity is the capability to regularly measure rates of ROIC and market competitiveness, and to assess what this means for buy, hold or sell decisions, and their timing.
- ▶ Systematic reviews help management proactively manage their business as a portfolio and prepare alternative transaction and restructuring strategies based on pre-determined performance metrics and valuation thresholds. This should also include the constant revisiting of the core business value proposition.
- ▶ Undertaking a comprehensive review of how capital has been deployed across geographies is also key – both developed and emerging markets, from assets to supply chains to JVs, to realign the portfolio as needed to ensure the right strategic presence in the most important future markets.
- ▶ All assets should be evaluated for under-use or under-performance to establish whether there is a better alignment of assets or whether they should be divested to reduce the overall capital base.

3 Accelerate synergy release from acquisitions

- ▶ Speed to value starts with highly focused pre-acquisition planning and diligence which targets exactly how efficiencies and synergies will be delivered, the timing of release of these and the impact on the overall cash profile of the organization. Immediate disciplined execution of those plans post acquisition should be supported by clear metrics and KPIs to track and prove benefits.
- ▶ Integration metrics should focus on business stabilization through the transition as well as benefits release. The use of leading indicators, such as customer feedback, as well as lagging indicators, such as financial performance, helps ensure early identification of any stability issues.



Raising capital

Faced with capital scarcity, companies are looking to diversify funding sources and are more fully preparing non-core assets for sale

Funding scarcity for several years

Our barometer shows that companies are expecting a prolonged period of difficulty in securing financing though there are a wide range of views on exactly how long “prolonged” is. Fifty-three percent of respondents do not expect mid-2007 financing conditions to return for at least 3 years and 19% for at least 5 years.

Regardless of when funding restrictions ease, it is clear that there will be intense competition for capital for at least the next 12 months as many facility renewal dates fall due. Those companies best able to convince investors of their stability as well as their ability to drive value from acquisitions will secure funds at the expense of others.

Increasing range of sources recognized but not yet fully exploited

Not all companies have a funding issue. Some large corporates have strong balance sheets, are operating in cash-rich sectors and find themselves with an unprecedented advantage in the transactions market. This may explain why the expected use of cash and debt over the next 12 months have changed only marginally compared to the last 12 months, with a slight swing towards debt. We believe this is also partly driven by government stimulus packages that, in the short term at least, will improve credit availability and pricing.

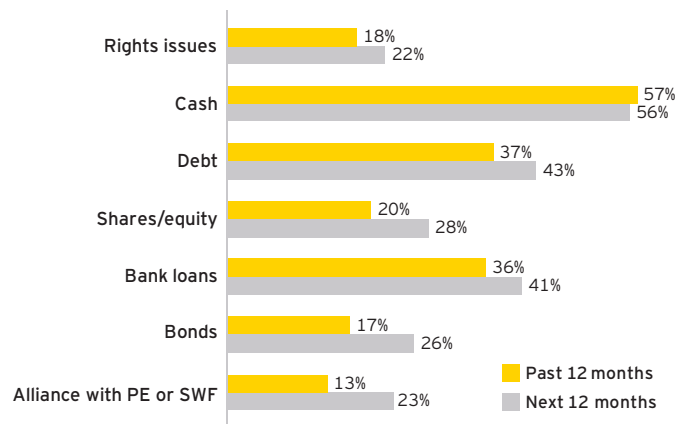
Boards should challenge their reliance on traditional sources of financing and the barometer shows a clear increase in the breadth of sources being considered such as bonds and shares. Private equity (PE) and Sovereign wealth funds (SWF) also register more strongly as future financing partners. This could be a major area of growth in the future and is potentially underexploited.

As equity markets rise, IPOs are also back on the agenda and we expect activity to pick up significantly in this area in 2010.

Which of the following are you likely to undertake or seriously consider in the next 6 and 12 months?



What was your main source of deal financing in the last 12 months, and what do you expect to be the likely sources in the next 12 months?



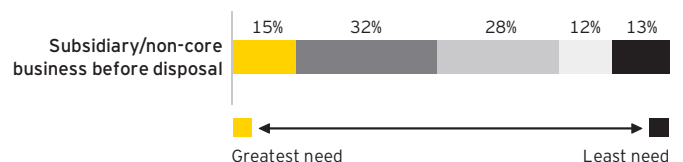
Divestments seen as source of capital but reticence on timing

In response to the scarcity of capital from traditional sources, 24% of companies looking to divest assets cite the main reason as to fund new investments or raise cash. There is however a recognition that realizing value will require full preparation for sale with 47% of respondents expecting to restructure subsidiary or non-core businesses prior to disposal.

If you are considering asset sales/divestments, what are your main reasons for doing so?



To what extent do you anticipate the need to restructure:



Despite the level of preparation, sellers are clearly concerned about timing – 18% of companies are expecting to divest in the next 6 months rising to only 21% within the next 12 to 24 months while the appetite for acquisitions in the same period increases markedly. Effective management of non-core assets for potential divestment is more important now than ever.

Building competitive advantage

Leading boards are adopting three key practices to better manage how future capital needs are met

1 Diversify funding sources, and maturities to build resilience and optionality and to establish a trust premium as an acquirer

- ▶ Maximum optionality, particularly including non-traditional sources, is a key lever for managing funding requirements and risk through a prolonged period of uncertainty. In addition, leading boards are looking to diversify maturity dates so as to minimize funding renewal and pricing risk.
- ▶ Consideration of alternative sources should take into account PE who may be valuable partners in delivering rapid integration, operational efficiencies, turnaround or more robust cash and working capital disciplines. SWFs should also be explored.
- ▶ Corporate bonds are becoming increasingly common as a means to raise finance without dependence on banks and many companies are looking to raise equity in overseas markets.
- ▶ As sellers look for certainty of close, multiple funding options and sources are key to building vendor confidence – vendors place a significant “trust premium” on the capacity to fund and this can lead to securing assets at lower prices than other acquirers.

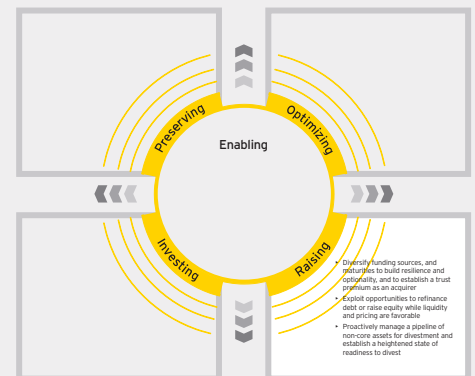
2 Exploit opportunities to refinance debt or raise equity while liquidity and pricing are favorable

- ▶ With over US\$6.7t of company debt due to refinance before 2012 in the US and Europe alone, companies face extreme competition for funds.
- ▶ We believe the infusion of capital into the markets from governments provides a relatively short window of opportunity in the next six to nine months to refinance, while pricing is comparatively favorable.
- ▶ Those doing so will build resilience and the capacity to acquire distressed assets coming to market as others experience refinancing difficulties.

3 Proactively manage a pipeline of non-core assets for divestment and establish a heightened state of readiness to divest

Securing value from divestments presents an unprecedented challenge. Leading companies are addressing this by:

- ▶ Identifying, continually reappraising, and managing as a pipeline, any non-core assets to be divested.
- ▶ Adapting financial reporting systems and cost allocation methods and assumptions to help ensure clear visibility of the performance and cash flows of the assets to be divested.
- ▶ Ensuring clarity of cost base and operational improvement opportunities – purchasers will need a clear line of sight to quantum and timing of benefits.
- ▶ Simplifying the carve-out path so that the asset can be readily understood and cleanly divested as and when required.
- ▶ Increasing rigor in commercial forecasts and sensitivities of top line to different economic scenarios and drop through impact on EBITDA as well as cash.



Investing capital

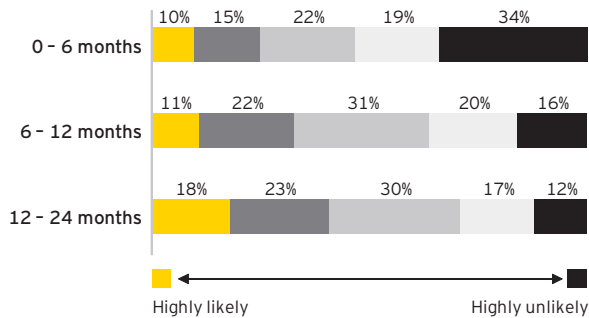
Anticipated growth in M&A will challenge traditional investment appraisal and transaction approaches placing new demands on corporate development functions. Readiness to execute in a distressed situation is key to securing advantage

Acquisitions back on the agenda

The barometer sounds a note of cautious optimism regarding acquisition activity. While there is no expectation that M&A activity will return to anything like its pre-crisis peak for some time, many companies are gearing up to transact. Twenty-five percent expect to be acquisitive in the next 6 months, rising to a third within the next year and to 41% within the next 12 to 24 months.

The primary reasons for acquisition reinforce other barometer findings in terms of strengthening the core business and increasing operational efficiency through economies of scale.

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

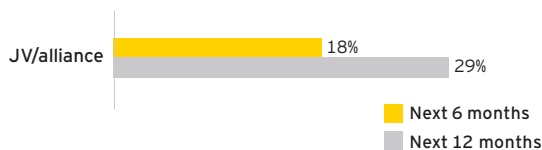


Joint ventures also on the rise

A major shift in interest in JVs is seen in our barometer with 29% of businesses stating a likelihood to enter into a such an arrangement in the next 12 months.

As companies seek to manage increased risk and conserve capital, JVs and strategic alliances can provide an ideal vehicle for entering strategic markets and geographies, in a risk managed way while also establishing strong local business partnerships.

Which of the following are you likely to undertake or seriously consider in the next 6 and 12 months?



New approaches required

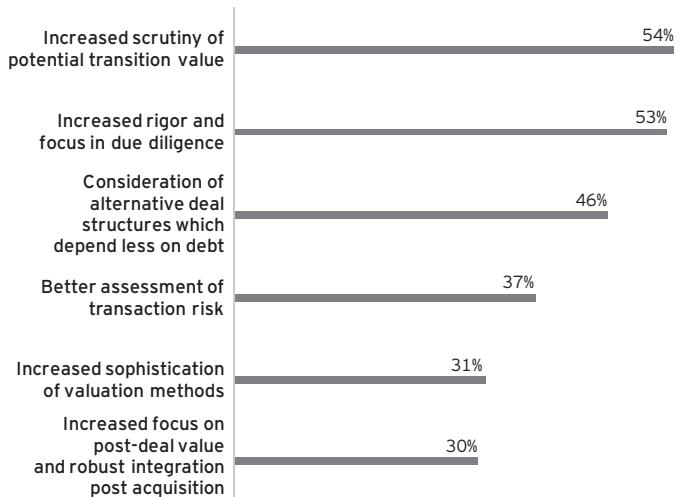
Despite the growing sense of anticipation that the deal drought may be ending, there is also a clear recognition that traditional methods for investing capital will no longer suffice.

Forty percent of our respondents declare that while they see opportunity and will be interested in pursuing this, they feel hampered by various restrictions. A range of potential obstacles are apparent including valuation uncertainty, investor caution and restricted financing.

For these to be overcome, new approaches are required for investment appraisal and execution.

Many companies are already adapting. They are increasing the use of scenario modeling and other techniques to help establish confidence in target value and resilience. They are also driving greater rigour and focus in due diligence and in post-deal integration. Finally, they are applying more sophisticated valuation methods and are considering a wider range of deal structures that depend less on debt.

What are the primary ways in which you are adapting your approach to transactions in response to the financial crisis?





Many are unprepared to acquire distressed assets

Investment appraisal and execution processes are further challenged when faced with a distressed acquisition opportunity.

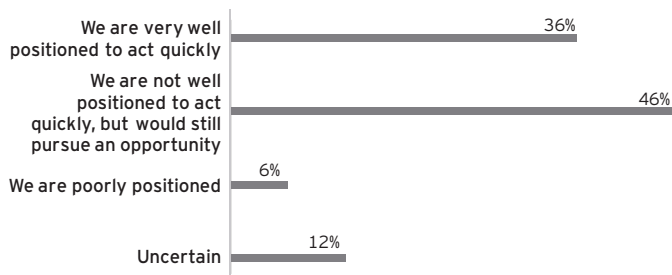
Many companies are simply not equipped to acquire an asset within the timetable typical of a distressed situation. They will see opportunities pass by, while others pick up assets at favorable prices and with minimal competition.

Forty-five percent of our executives expect an increase in the number of distressed assets coming to market, yet only 36% of businesses feel that they are well positioned to act quickly. Establishing the processes and capacity to compete for distressed assets will be a key factor in establishing competitive advantage over the next 12 months.

Which of the following best characterizes what you expect to see in your sector in the next 12 months as a result of the crisis?



How well positioned is your company (in terms of finance and decision-making) to execute an acquisition at short notice (i.e., less than 30 days) should a good opportunity present itself?

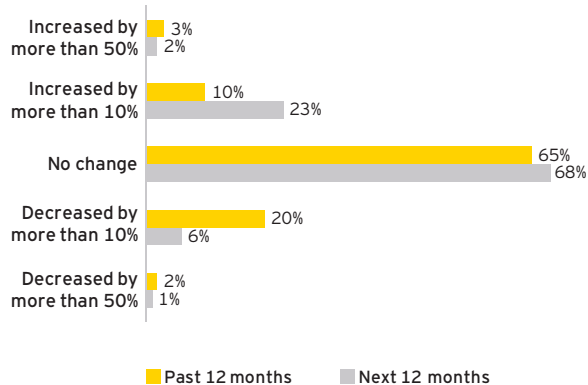


A more central and challenging role for corporate development

The development of enhanced transaction processes points to a more central and strategic role for corporate development functions. These factors, along with the expected increase in acquisition activity may account for why 23% of businesses are expecting their in-house M&A teams to increase in number by more than 10% in the next 12 months.

Our barometer suggests further demands are likely to come in the form of portfolio evaluation, preparation of assets for sale, entering into JV arrangements, innovative financing and reshaping of the capital structure.

Has the number of people in your in-house M&A team decreased or increased over the last 12 months, and your expectations over the next 12 months?

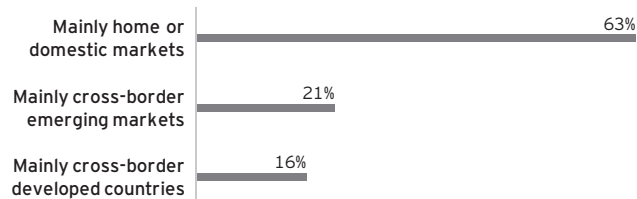




Acquisition focus by geography

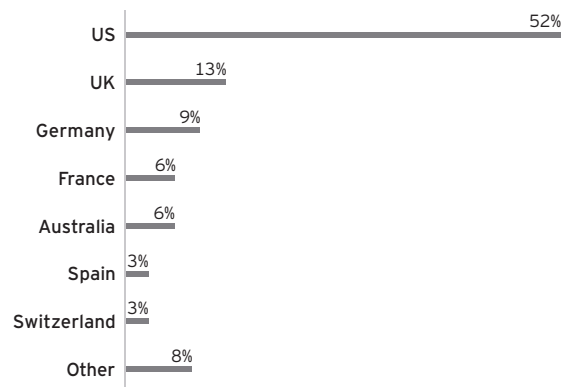
Where do you see the most attractive acquisition opportunities in the next 12 months?

Domestic acquisitions are the primary focus but interest remains in cross-border emerging markets



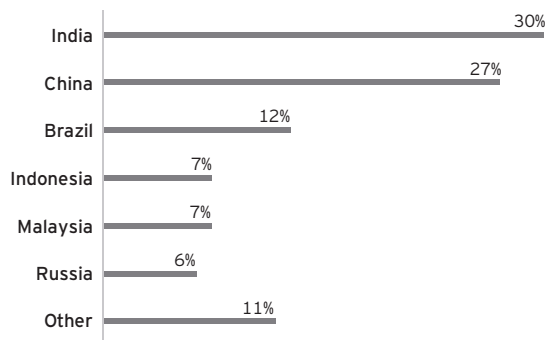
...most attractive developed markets?

US dominates developed markets acquisition interest



...most attractive emerging markets?

India and China are the primary focus for emerging markets acquisitions



Building competitive advantage

Leading companies are focused in three areas to adapt their capital investment processes

1 Upgrade investment appraisal – rigorous stress testing of investment cases and more focused due diligence targeted at recession resilience

- ▶ Leading companies are undertaking root and branch reviews of their investment appraisal processes to determine changes that will improve the quality and speed of decision-making.
- ▶ In particular, boards are focused on modifying discount and hurdle rates, recognizing the current challenges to cost of capital and balancing shorter term cost of capital issues with a long-term perspective.

Focus due diligence on the following key areas:

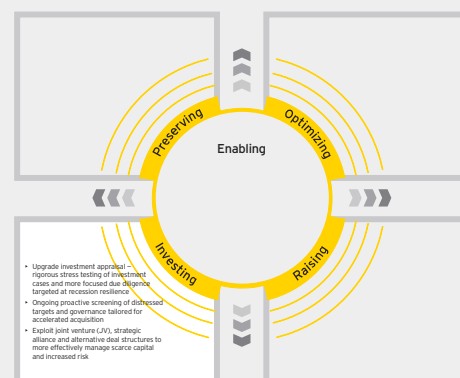
- ▶ The strength of the underlying equity growth story for different economic performance scenarios, factoring in geographic risk.
- ▶ Downturn impact on the underlying operations of the asset. Impact of the deferral of any essential investment. Extent of cost reduction undertaken and any resultant negative synergies.
- ▶ Economies of scale, speed and route to synergy value as well as any stabilization risks.
- ▶ Stability of cash and working capital and sensitivity to different economic scenarios.
- ▶ Strength of the management team. Experience to lead through prolonged downturn.

2 Ongoing proactive screening of distressed targets and governance tailored for accelerated acquisitions

- ▶ Be ready and know what you would be prepared to acquire on an accelerated timetable.
- ▶ Agree on a set of principles and a process that can underpin and govern accelerated acquisitions while managing heightened risk.
- ▶ Develop a strong understanding of how to navigate the insolvency process in the acquisition of a distressed asset, including the tax aspects of this process.

3 Exploit joint venture, strategic alliance and alternative deal structures to more effectively manage scarce capital and increased risk

- ▶ Explore fully JV and strategic alliance arrangements as a means to more efficiently invest scarce capital, particularly in higher risk geographies.
- ▶ Consider alternative deal structures to bridge buyer and seller expectations. These may include structures that involve deferred consideration, earn-outs and more extensive use of reps and warranties.





Enabling the capital agenda

More robust data and better techniques to plan, forecast and model different scenarios are key to more effective management of capital in an uncertain environment

New approaches to strategic decision-making

The "burden of proof" to justify a major strategic investment decision is substantially higher than it has ever been.

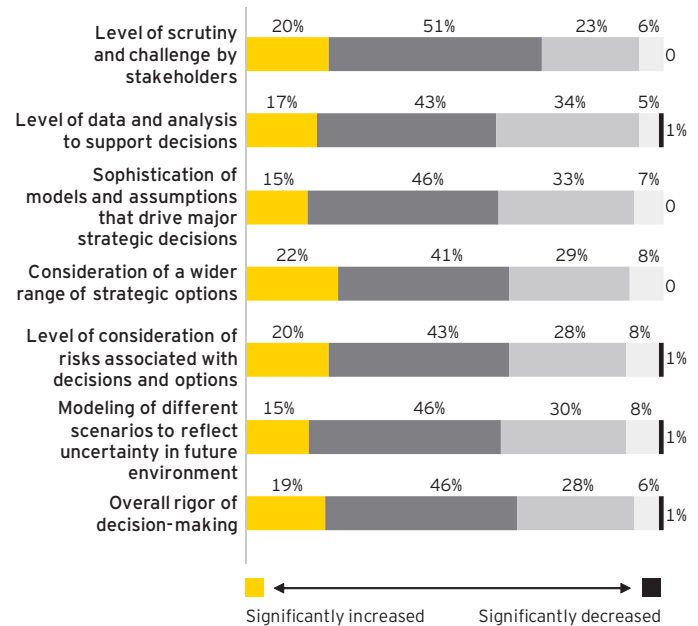
A striking finding of our barometer is the extent to which strategic decision making processes are evolving to adapt to the uncertain environment. Under increased scrutiny from stakeholders, companies are having to enhance their processes in a number of key areas.

The level of data and analysis that is being produced to support decisions has either increased or significantly increased for 60% of our respondents.

Substantially more work is going into options and scenario modeling – with a significant increase in sophistication of assumptions that drive forecasts – enabling risk and uncertainty to be quantified and flexed to a changing environment.

Finally, the overall rigor of the decision making process itself has increased significantly as cautious stakeholders demand greater visibility and assurance that key decisions are well supported and carefully considered.

With respect to your strategic decision-making, what do you expect will be the impact of the financial crisis in each of the following areas?



All of this could be read as adding time, complexity and bureaucracy to a process where speed is increasingly a critical success factor. For those that fail to develop their capabilities and tools in this area, that will almost certainly be the case. Others will see the imperative and invest in developing their systems and processes accordingly.

Those adopting these practices early and most effectively are likely to gain an edge on their competitors.

Building competitive advantage

Leading companies are enabling more effective management of the capital agenda in three key ways

1 Adapt and improve planning, budgeting and forecasting to enhance control, discipline and flexibility

Boards are looking at changing both the frequency and way they ask operations to plan and forecast.

Innovations we are seeing include:

- ▶ Rolling forecasts and rolling trend analysis to improve visibility and eliminate inevitable bias or optimism that outturn-only incentives schemes may encourage.
- ▶ The use of leading indicators instead of relying simply on outputs and financial results (e.g., customer demand, production volume, capacity utilization etc) to link business drivers to planned performance. This has particular relevance to organizations looking to drive greater efficiencies through the supply chain or assessing the effects of alternative restructuring/cost reduction strategies.

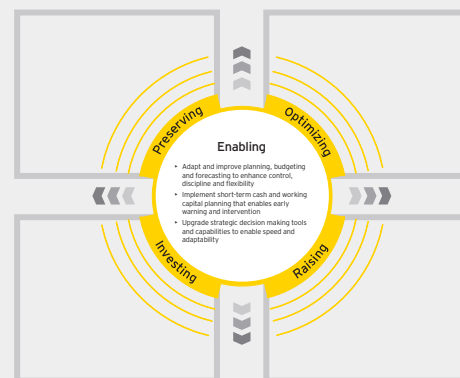
2 Implement short-term cash and working capital planning that enables early warning and intervention

- ▶ Short-term cash and working capital planning and forecasting helps establish a better line of sight into business operations and support intervention.
- ▶ Many companies still struggle to produce robust medium-term cash, debt and funding forecasts because of the lack of a fully integrated P/L, balance sheet and cash flow forecasting capability – this has become a minimum requirement in building stakeholder confidence in forecasts.

3 Upgrade strategic decision-making tools and capabilities to enable speed and adaptability

The downturn has made many boards realize that they simply don't have the right information readily available to support the decisions they need to make.

- ▶ Far greater levels of automation and functionality are needed in strategic planning tools to meet the demands of the current environment if boards are to be able to respond quickly enough. They need to be able to consolidate numbers almost instantly, be able to ask "what-if?" and see the results.
- ▶ Invest in more capable "best-of-breed" data analytics tools to support decision-making. These tools help improve confidence in the quality and speed of the boards decision making capability.
- ▶ Develop scenario planning and strategic options modeling capabilities to enable stress testing of plans and capital adequacy against potential changes in market conditions, and to evaluate alternative options for both strategy and capital structure.



The capital agenda holds the key to competitive advantage in an uncertain world

This will be a slow and hard-fought recovery with shocks along the way. Economic uncertainty, increased risk, capital scarcity and investor caution all threaten to impede strategy implementation and impact shareholder return. Boards are challenged now as they have never been challenged before around the effective management of capital.

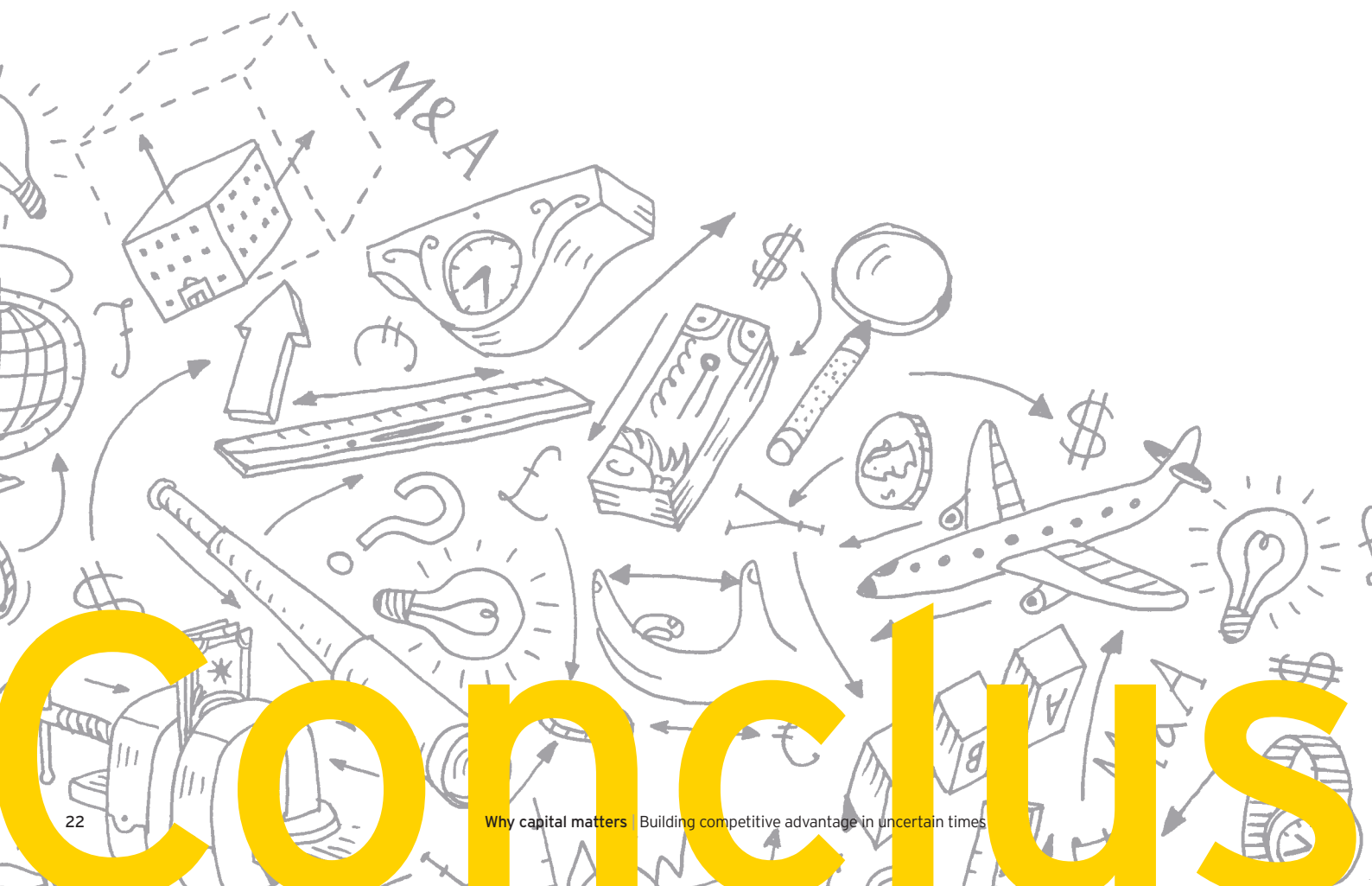
In response, leading companies have been galvanized to drive a more focused, disciplined and rigorous capital agenda.

They recognize alongside the risk that there is also opportunity, that operational fitness and resilience must be developed alongside a flexibility to respond quickly as the market changes. The only certainty is uncertainty – those who learn how to make the best decisions in an uncertain world will win.

A disciplined capital agenda is the key to:

- ▶ Building and maintaining investor confidence
- ▶ Winning the competition for scarce capital
- ▶ Anticipating and adapting to market conditions as they change
- ▶ Seizing acquisition and other growth opportunities that others are unable to

Those that move first to develop the capabilities and focus demanded by this agenda will build their competitive advantage while others falter. These companies will emerge as the leaders as the post-recession landscape unfolds.

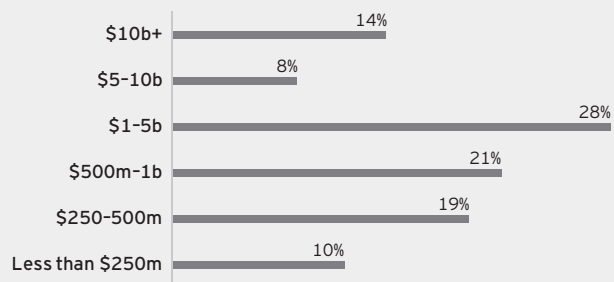




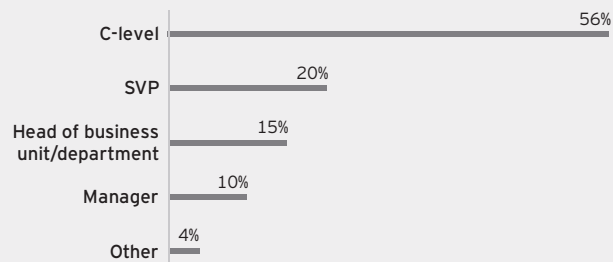
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Study demographics

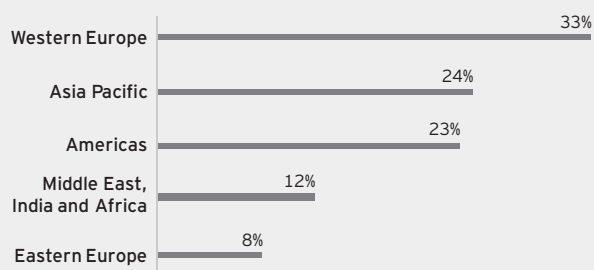
What are your company's annual global revenues in US\$?



What is your position in the organization?



In which region are you located?



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