The Dutch Deloitte CFO Survey

Uncertainty dampens optimism

2010 Q2 results
July 2010

Contents

Uncertainty dampens optimism

We are proud to present our sixth quarterly survey of Chief Financial Officers in the Netherlands, as part of the Deloitte CFO Initiative. The survey gauges attitudes to valuations, risk and financing, and reports trends and turning-points for you and your business.

Key points from the 2010 Q2 Survey

- CFOs' optimism about their financial prospects has dropped.
- Though almost 70% of CFOs expect their company's cash flow to increase over the next 12 months, the trend is declining.
- Corporate debt is perceived as the most attractive source of funding; equity and bank borrowing are perceived as less attractive.
- Perceived attractiveness of equity issuance shows a sharp decline.
- More than half of the CFOs expect to arrange new funding over the next 12 months.
- The outlook for M&A is still high over the next 12 months, but expectations have dropped since the last quarter.

- CFOs prefer mitigation of the tax burden on labour in order to improve the conditions for business development in the Netherlands.
- CFOs prefer a relatively simple thincap scheme, with a maximum debt/equity ratio of 3:1 for both internal and external interest regarding the tax settlement of interest paid.

General economic environment

The global recovery faced new headwinds this second quarter. Financial instability in the Southern European countries has bedeviled the financial markets. The realization sets in that the financial crisis not only affects the banking system but makes governments vulnerable too. A wave of austerity is sweeping across Europe as governments seek to reduce budget deficits. Government bonds as safe haven are split in core government bonds with a low interest to be paid, like Germany and the Netherlands, and peripheral bonds with higher interest levels, like Greece and Spain.

The Governing Council of the European Central Bank decided that the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will remain unchanged at 1.00%, 1.75% and 0.25% respectively. The stock exchange markets' reaction to this uncertainty (e.g. in government financing and declining growth in China) was very volatile.

Meanwhile growth is proceeding at a very different pace around the world. China and emerging markets are leading, followed by the US and Japan, with Europe lagging. The Netherlands Bureau for Economic Policy Analysis (CPB) has adjusted the predictions about the Dutch growth by minus 0.25%, to 1.25% in 2010 compared with three months ago.

Most economists believe the double dip is not the most likely scenario to happen. A double dip needs another recession, which is not going to happen according to the U.S. Central Bank (Fed), which estimates the chance of this occurring at 12% (small). The American economy might cool down in the second half of 2010. Globally, the prevalent alternative right now is a flat scenario.

CFO Survey

Financial optimism among CFOs has dipped for the second consecutive quarter, returning to the levels of 2009 Q2. The cash flow outlook of CFOs for the next 12 months is tightening somewhat since the start of 2010. Almost half of the CFOs reduced the financial risk on their balance sheet over the last twelve months and three-quarters of CFOs state that now is not a good time to be taking greater risk onto their balance sheet. This is no change in comparison to the first quarter of 2010.

CFOs experienced funding to be somewhat cheaper, but also somewhat less accessible. This endorses the perceived uncertainty. The attractiveness of equity as a favoured source of funding dropped to about the same level as bank borrowing. Corporate debt is now the CFOs favourite source of funding since this quarter. More than half of the CFOs are likely to issue debt over the next twelve months.

The outlook for mergers and acquisitions is still very positive, but expectations are cooling down in comparison to the last quarters.

Conditions for business development

The special questions of this quarter's CFO Survey focus on tax measures to improve the conditions for business development in the Netherlands.

Current fiscal policies regarding Dutch conditions for business development mainly focus on lowering the tax burden on capital. The results of this survey show that CFOs prefer mitigation of the tax burden on labour in order to improve the conditions for business development in the Netherlands.

As from 2011, the cost allowance facility for employees will be replaced by a general labour costs facility. Most CFOs believe this will lower the administrative burden. However, the operating expenses are expected to increase which implies a raise of gross labour costs.

Interest paid is deductible for corporate income tax purposes, while a dividend distribution is not. In terms of taxation this has led to various limitations on the deduction of interest in Dutch corporate income tax. This system is very complex and will be revised. Various options for revision of this system are possible. CFOs prefer a relatively simple thincap scheme, with a maximum debt/equity ratio of 3:1 for both internal and external interest. This would not lead to a substantial change in the corporate income tax rate. However, this is not an option the Dutch government is currently considering.

Financial outlook

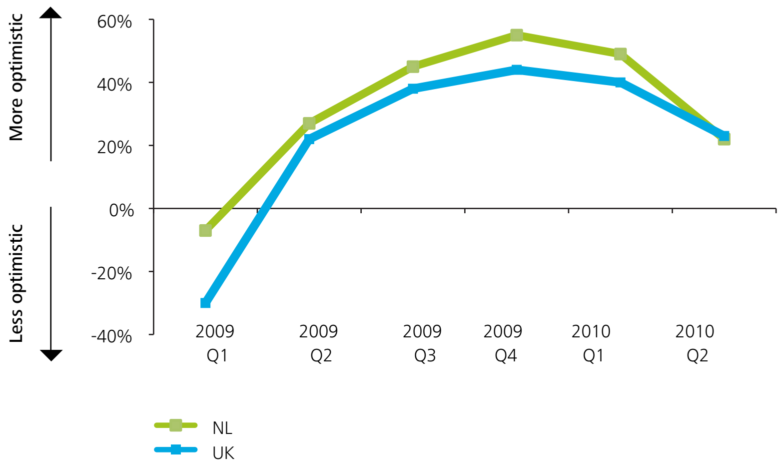
Uncertainty about the pace of future recovery leads to a significant drop in CFO optimism.

The Dutch figures show the same movement as the UK. The upward trend of 2009 has definitely come to an end.

The Dutch economy is expected to grow by 1.25% this year and 1.75% in 2011 according to the Netherlands Bureau for Economic Policy Analysis (CPB). This is an adjustment of minus 0.25% in comparison to the outlook of three months ago.

Chart 1. Financial prospects NL & UK

Net percentage of CFOs who are more optimistic about the financial prospects for their company now than three months ago.

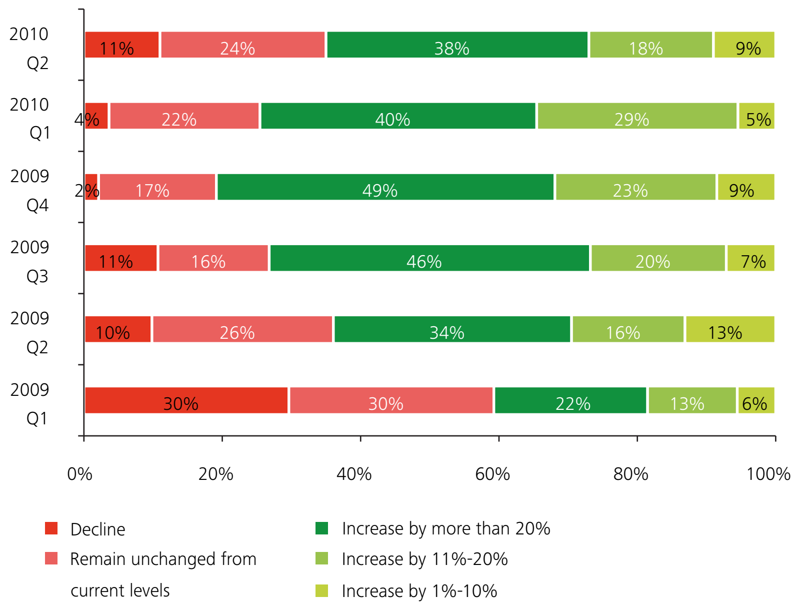


CFO optimism about their free cash flow expectations has continued to decline.

Nevertheless, almost 70% of CFOs expect their free cash flow to increase over the next 12 months.

Chart 2. Change in cash flow next 12 months

How do you expect your operating or free cash flow for your company to change over the next 12 months?



Risk

Most CFOs continued to reduce balance sheet risks at a similar pace as last quarter.

The survey results show a high dispersion of the aimed level of gearing by CFOs for the coming 12 months (not shown in chart). One third of CFOs aim for a reduction in their level of gearing, one third aim for a raise, one third aim for their gearing level to remain unchanged.

Chart 3. Change in financial risk* on balance sheet
Percentage of CFOs reporting that the level of financial risk on their balance sheet increased/decreased over the last 12 months.

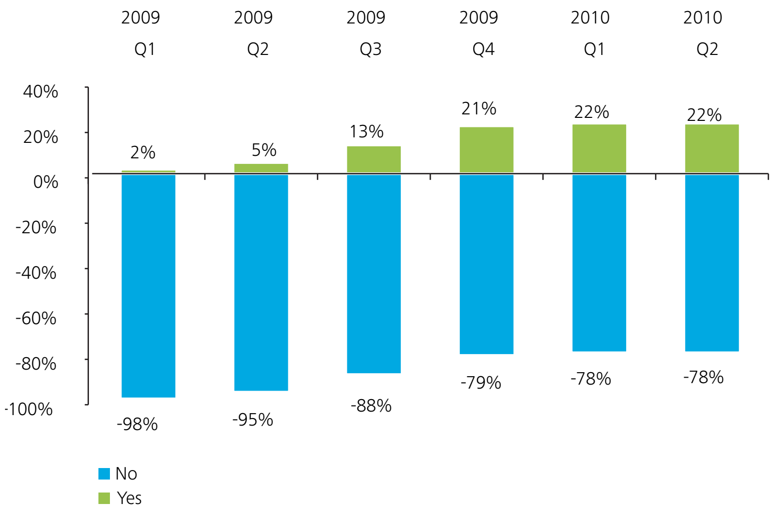
* Financial risk could include, e.g. levels of gearing, uncertainty about the valuation of assets and interest rate and exchange rate sensitivity.

Since the fourth quarter of 2009 the risk attitude of CFOs remains unchanged.

The large majority of CFOs state that now is not a good time to be taking greater risk onto the balance sheet.

Uncertainty may drive cautiousness.

Chart 4. Attitude towards greater risk on balance sheet
Percentage of CFOs reporting now is (not) a good time to be taking greater risk onto the balance sheet.



Funding

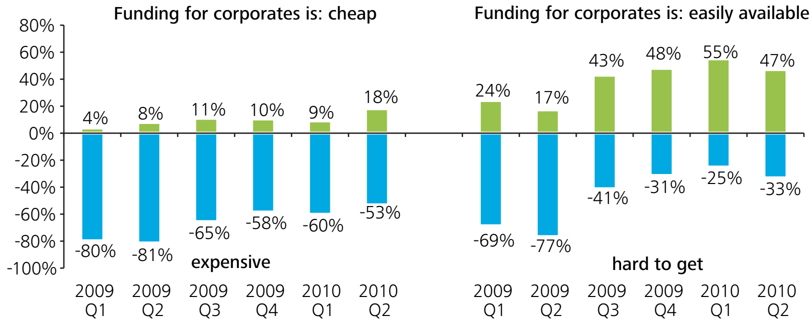
More CFOs state that funding is harder to get in comparison to the last quarter, confirming increased uncertainty.

CFOs state that funding became somewhat less expensive. The low interest rates continue to contribute to this. Some banks have lowered their surcharge.

However, half of the CFOs still perceive funding to be expensive.

Chart 5. Cost and availability of credit

Percentage of CFOs reporting funding for corporates is expensive/cheap and hard to get/easily available.

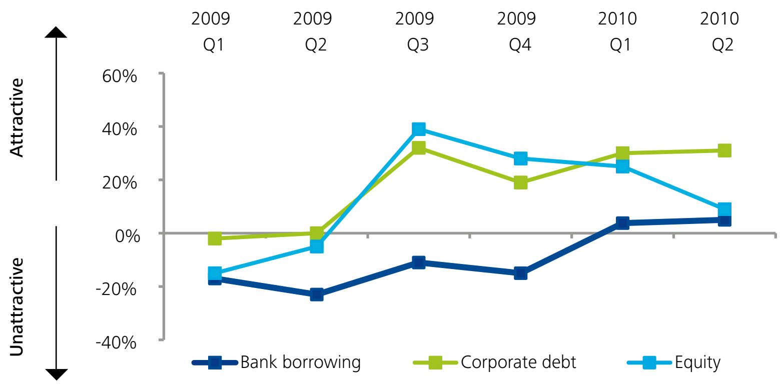


Equity has lost some of its attractiveness as source of funding, which has dropped to the same level as bank borrowing.

Corporate debt remains the most attractive source of funding according to most CFOs.

Chart 6. Favoured source of corporate funding

Net percentage of CFOs reporting the following sources of funding as (un)attractive.

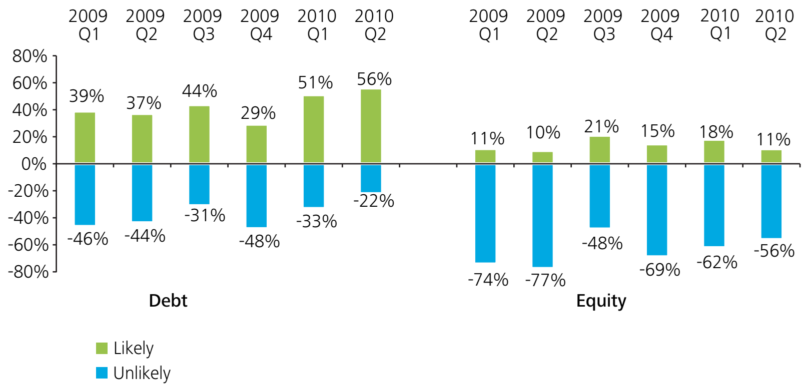


The attractiveness of debt as funding source is confirmed by the CFOs planning for funding over the next twelve months.

56% of the CFOs are likely to issue debt. Refinancing of current debt positions may contribute to this.

Chart 7. Likely to issue debt/equity?

Percentage of CFOs who are (not) likely to issue debt / equity over the next 12 months.

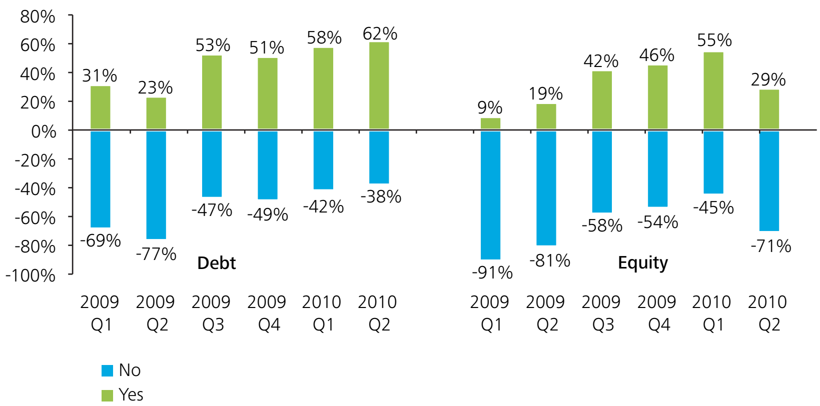


A sharp decline in appetite of equity issuance confirms that CFOs think the issuance of equity has lost momentum, reflecting uncertainty in price-setting.

Most CFOs still believe that equity in general and of their own company is undervalued, so market prices will not meet their expectations.

Chart 8. Good time to issue debt/equity?

Percentage of CFOs who think now is (not) a good time to issue debt/equity.



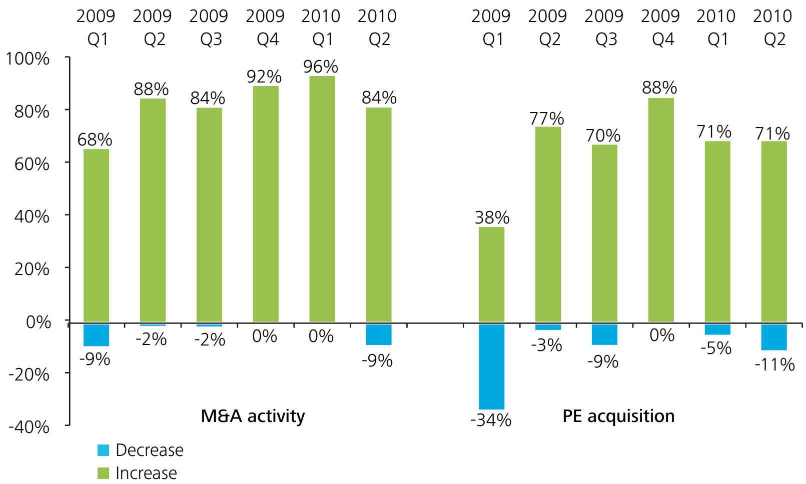
Equity / M&A

Last quarter almost every CFO expected M&A activity to increase in 2010. Uncertainty in the market reduced these expectations this quarter.

The expectations for Private Equity activity remain almost unchanged.

Chart 9. M&A and Private Equity outlook

Percentage of CFOs who expect M&A and PE activity to increase in the next 12 months.



After the equity dip at the end of 2008 and beginning of 2009, 2009 clearly has been a year of recovery. An upward trend is visible and 2010 started to continue this trend.

However, due to all the uncertainty in the financial markets a dip has occurred during this last quarter. The upward trend has come to an end. At the end of the second quarter of 2010, the stock markets are moving sideward with a high volatility, awaiting signals of recovery.

Chart 10. Closing prices of the AEX-index

For the first time a small drop is visible in the CFOs' expectations that the AEX-index will be at a higher level in twelve months from now.

Interestingly CFOs' expectations about the AEX-index are reflected in the actual movement of the AEX-index.

Chart 11. AEX Outlook

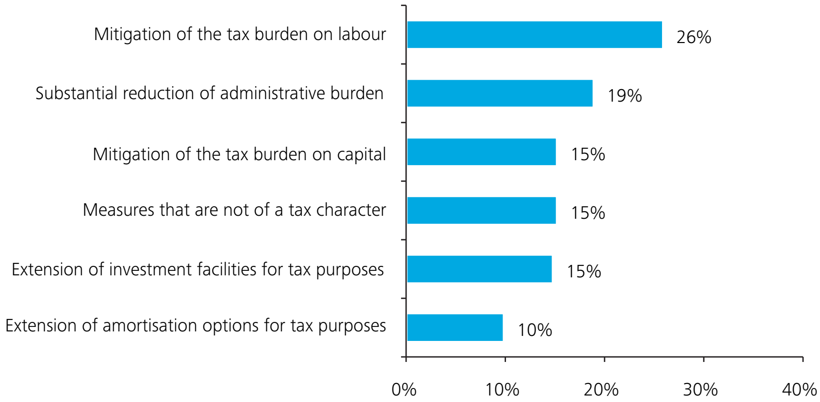
Percentage of CFOs who expect the AEX-index to be higher/lower in 12 monthts.

Conditions for business development

Current fiscal policies regarding Dutch conditions for business development mainly focus on lowering the tax burden on capital. This chart shows that CFOs prefer mitigation of the tax burden on labour in order to improve the conditions for business development in the Netherlands. The popularity of the 30% facility for expats working in the Netherlands endorses this. In practice, this facility lowers the tax burden by 30% for companies sending employees to the Netherlands.

CFOs prefer a substantial reduction of the administrative burden as the second favoured measure. CFOs clearly see options to improve this. Apparently, the government efforts in this area did not yet yield the results initially anticipated.

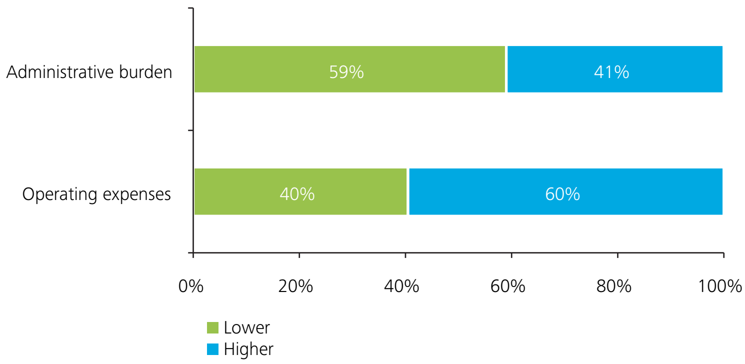
Chart 12. Measures to improve conditions for business development
Weighed ranking of measures favoured by CFOs to improve conditions for business development.



As from 2011, the cost allowance facility for employees will be replaced by a general labour costs facility, with which the size of the maximum tax-free allowance to be provided to all employees together is determined in accordance with the wage bill (1.4% of the wage bill), while the Tax Administration will no longer check individual cost allowances. Any surplus allowance will be taxed with the employer at 80%.

Almost 60% of CFOs expect this measure will lower the administrative burden. However, 60% of CFOs also expect this measure will raise the operating expenses. This means CFOs expect the gross labour costs - already high in the Netherlands - to rise. This would imply a deterioration of the Dutch business conditions, where the Dutch government strives to improve these conditions.

Chart 13. Effect of labour costs facility
Percentage of CFOs who expect the effect of the labour costs facility to be higher/ lower on the companies:

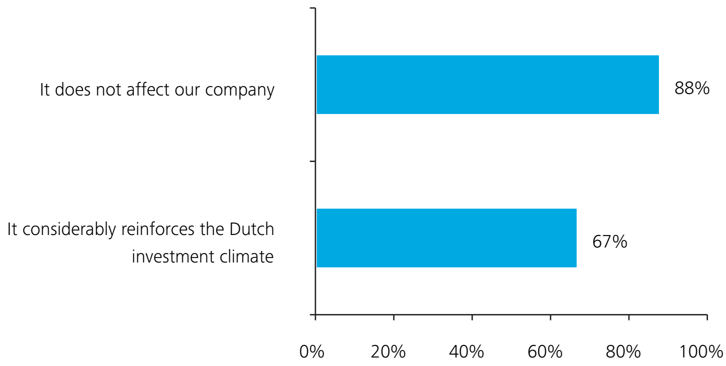


One of the proposed options to improve the (tax) conditions for business development is to abolish the dividend withholding tax. The net costs for the government are some EUR 800 million. However, lifting this regulation will hardly impact the dividend policies, because it often concerns a withholding tax. Hence, it does not lower the burden on capital.

Most CFOs state indeed that abolition of the dividend withholding tax will not affect their company. However, two thirds of CFOs does expect this will reinforce the Dutch investment climate. Dividend withholding tax for foreign companies receiving dividend from a Dutch subsidiary is already often lowered to a zero rate under international tax treaties. So the expected effect is likely to be small. However, for some foreign institutions which are exempted from tax or which are established in a non-treaty country, abolishing the dividend withholding tax will be attractive and therefore perhaps will increase their investments in the Netherlands.

Chart 14. Abolition of the dividend tax

According to CFOs, how will abolishing the dividend tax affect their company and the Dutch investment climate.



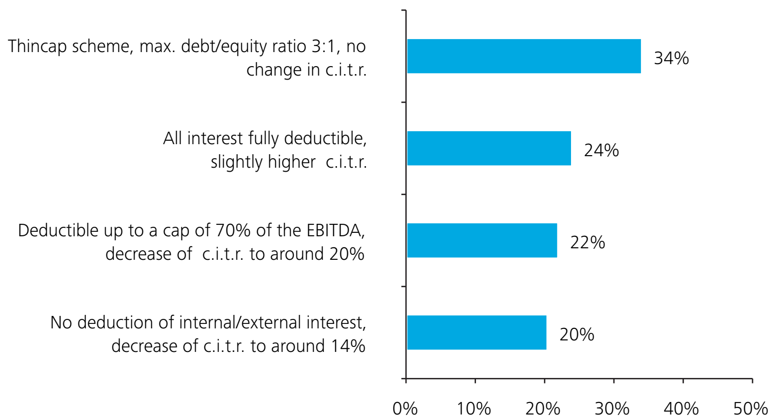
Interest paid is deductible for corporate income tax purposes, while a dividend distribution is not. In terms of taxation this has led to various limitations on the deduction of interest in Dutch corporate income tax. This system is very complex. Various options for revision of this system are possible.

CFOs prefer a relatively simple thincap scheme, with a maximum debt/equity ratio of 3:1 for both internal and external interest. This would not lead to a substantial change in the corporate income tax rate.

This concerns an option which the Dutch government is currently not considering to introduce. One of the alternatives considered by the government is the Ebitda, which Germany has introduced as well. CFOs are generally not overly enthousiastic about this alternative, notwithstanding the fact that it is also relatively simple and other limitations on interest deductions can be eliminated.

Chart 15. Tax deduction of interest

Percentage of CFOs who prefer one of the following options regarding tax deduction of interest.



A note on methodology

To enhance readability not all survey questions will be reported in each quarterly survey. Survey questions will be selected in response to the current financial economic situation. If you wish to receive information about non-reported questions, please contact us. The Deloitte CFO Survey is also executed by other Deloitte countries, for instance in the UK. Comparisons will be made when relevant.

Some of the charts in the Dutch Deloitte CFO Survey show the results in the form of a net balance. This is the percentage of respondents reporting, for instance, that bank credit is attractive minus the percentage stating that bank credit is unattractive. This is a standard way of presenting survey data. Due to rounding answers may not sum to 100%.

The 2010 Q2 survey took place between 7 June and 30 June. A total of 45 corporate CFOs completed our survey. Representing a net turnover per company of approximately EUR 2.0 billion. The responding companies can be divided into the following categories: less than 100 million (7%), 100 – 499 million (41%), 500 – 999 million (16%), 1 – 4.9 billion (25%), more than 5 billion (10%), unknown (2%).

The participating CFOs are active in a variety of industries (Healthcare, Construction, Retail / Wholesale, Real Estate, Consulting, Leisure / Entertainment, Technology, Communication, Energy & Utilities, Manufacturing and Banking / Finance / Insurance).

We would like to thank all participating CFOs for completing our survey. We trust that the report makes an interesting read and highlights the challenges facing CFOs. We also hope that it provides you with an important benchmark to understand how your organization rates among your peers.

Source:
Deloitte Research NL

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