The Dutch Deloitte CFO Survey
External conditions limit optimism

2011 Q1 results
May 2011
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We are proud to present our ninth 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 2011 Q1 Survey
• Bank borrowing is perceived as the most attractive source of funding for the first time since the start of this survey.
• CFO optimism has decreased after two quarters of recovery.
• The risk appetite returned to former levels. The peak at the end of 2010 did not last.
• Most CFOs expect their free cash flow to rise over the next twelve months. In comparison with the last quarter more CFOs (22%) expect a rise by more than 20%.
• Almost half of the CFOs assess Chinese takeovers in Europe to create an opportunity for their company.
• If they were to contemplate selling business units, half of the CFOs consider a Chinese company to be a serious buyer.

CFO Survey
The financial optimism among CFOs seemed to stabilize at a higher level during the fourth quarter of 2010. However, the external conditions were unfavourable and thus influenced trade and daily business. As a result, the level of optimism has decreased again.

Although less CFOs expect their companies’ cash flow outlook to increase over the next 12 months compared with last quarter, overall more than half of the CFOs expect an increase. After years of cost reduction programs and with the price levels of materials being on the rise, margin pressure is tight. This requires corporates to find new ways to optimize their cash flow. Options are to further reduce working capital, execute segmentation analyses of clients or products in order to optimize margin or focus on pricing strategies.

The risk appetite returned to former levels after a rise in the last quarter. 21% of the CFOs consider now to be a good time to be taking greater balance sheet related risks. Undeniably, the conditions mentioned earlier influencing the financial markets explain this reset.

Bank borrowing is now perceived as the most attractive source of funding for the first time since the start of this survey. This is most likely explained by the consequences of the credit crunch leading to solvency and liquidity issues at the banks, which meant that bank borrowing became very hard to come by. During the fourth quarter of 2010 a majority of banks in The Netherlands relaxed their standards for approval of loans to enterprises for the first time since 2006, according to the DNB Bank’s Lending Survey of January 2011.

General economic environment
A lot has happened worldwide during the first quarter of 2011. Events such as the earthquake and its subsequent tsunami and nuclear disaster in Japan, the political turmoil in the Middle East, the financial unrest in Europe caused by the debt positions of Greece and Portugal, and the increasing discomfort with America’s budget deficit certainly left their mark on trade and daily business. These external events contributed to high oil prices, increasing price levels of raw materials and increased interest rates to cope with potential inflation.

During the first quarter of 2011 the interest rates of the European Central Bank were still low at the level of 1% for the main refinancing operations. On 7 April 2011, the Governing Council of the European Central Bank decided to increase the key ECB interest rates by 0.25%, after having maintained them at historically low levels for almost two years. The interest rates on the main refinancing operations, the marginal lending facility and the deposit facility are now 1.25%, 2.00% and 0.50% respectively. The growing fear of rising inflation levels is palpable. The ECB stresses: “All in all, it is essential that the recent price developments do not give rise to broad-based inflationary pressures over the medium term.”
Bank borrowing has traditionally taken the biggest share in the financing mix of most Dutch companies. Because of the credit crunch companies were forced to reform and spread their financing mix to avoid dependence of a single funding source. By now, bank borrowing is becoming more readily available to companies - although somewhat more costly since interest rates are rising again.

**M&A activity of Chinese companies**

So it is said that

if you know your enemies and know yourself, you can win a hundred battles without a single loss.

If you only know yourself, but not your opponent, you may win or may lose.

If you know neither yourself nor your enemy, you will always endanger yourself.

(Sun Tzu, a high ranking military general and strategist of the Kingdom of Wu (China) who lived in the sixth century BC)

China, currently the second largest economy of the world, still grows its economy at a fast pace. The total value of (announced) takeovers by Chinese enterprises in Western Europe over the 2001–2010 period came to some USD 47 billion, spread across 136 transactions, according to DNB. For the next few years, Chinese companies are expected to increase their M&A activities in Europe. How will this trend impact Dutch corporates and their competitive position?

Until today, Chinese companies have done limited M&A into Europe and therefore still have to learn about the European way of doing business when dealing with takeovers. Therefore, European companies should prepare themselves strategically to effectively compete with Chinese companies in making deals.

Even if companies think that increased Chinese M&A activity will not affect their company, larger corporates should realize that whenever they contemplate buying companies in their supply chain or tender for a contract in the near future, they will increasingly be in competition with interested Chinese parties.

Over 40% of the responding CFOs consider the Chinese takeovers in Europe to be an opportunity for their company, despite failed attempts, such as the efforts of Xinmao to buy Draka. Several factors, including financing issues and complex regulations for listed companies, prevented the takeover. Nevertheless, the Chinese companies are likely to be fast learners.

A private company will be more willing to invest time to resolve any cultural issues to close a deal with a Chinese buyer successfully when good terms are offered.

Despite the social debate around ownership of Dutch corporates, almost half of the CFOs would contemplate selling company business units to Chinese buyers.

With the recommendation of Sun Tzu in mind, Dutch companies should prepare themselves well to maximize their chances to win M&A or business deals from their Chinese competitors.
After the second half of 2010 showed a steady level of optimism, the level decreased in the first quarter of 2011. A drop to which the worldwide turmoil during this period – events such as the earthquake with subsequent tsunami and nuclear disaster in Japan, the political unrest in the Middle East, the financial unrest in Europe caused by the debt positions of Greece and Portugal, and the increasing discomfort with America’s budget deficit, the high oil prices, and increased price levels of raw materials - will obviously have been instrumental.

The trend is similar to that in the UK.

Just as many CFOs are expecting an increase in their cash flow over the next twelve months as in the two last quarters. However, the expected level of the increase differs.

The group of CFOs expecting their cash flow to increase by more than 20% rises to 22%.
Where the risk appetite increased during 2010 and reached its highest level at the end of 2010, the level dropped to former levels again.

27% of the corporate CFOs think now is a good time to be taking greater balance sheet related risks (UK 32%).

More than a quarter of the CFOs report an increased level of financial risk on their balance sheet over the last 12 months.

This level increased in compared with the fourth quarter of 2010. Perhaps this partially explains the declining group of CFO’s reporting now is a good time to further increase balance sheet risks (chart 3).

* Financial risk could include, e.g. levels of gearing, uncertainty about the valuation of assets and interest rate and exchange rate sensitivity.
Although the CFOs perceived the cost of credit to have remained the same level as at the end of 2010, the availability of credit improved, and continues to be slightly positive.

During the credit crunch corporates were forced into financial restructurings and to reduce their risk profiles. On the other hand the banks were forced during the crisis to improve their solvency and liquidity levels. Because of their improved financial position, banks are now in the position again to supply credit to healthy corporates.

According to the DNB Bank Lending Survey of January 2011: “Banks reported a broad relaxation of credit standards during the fourth quarter of 2010 compared to the preceding quarter. This applied to both large and small enterprises and to both short-term and long-term loans.”

The improved availability of credit benefits the attractiveness of bank borrowing. The Dutch CFO survey started during the credit crunch when bank borrowing was hard to come by. Now, for the first time since the start of this survey, bank borrowing is perceived as the most attractive source of corporate funding.

Equity issuance is regarded a less attractive financing alternative for companies than debt issuance. However, the attractiveness of equity issuance as a means of funding is still on the rise.
62% of the CFOs think now is a good time for equity issuance.

Conversely, debt shows a minor decline and aligns with interest levels being slightly up.

CFO priorities
Organic growth stays on the high priorities list for the next 12 months, although the urgency seems to decrease compared with the last quarter of 2010.

One of the rising priorities is “increasing capital expenditure” (20%). Based on another CFO survey question (the expected change of key metrics for corporates in the Netherlands), 68% of the CFOs expect an increase in capital expenditure in general for NL based corporates over the next twelve months. Apparently, now is a good time to catch up on delayed investments.
Expectations for increased M&A (86%) and private equity (86%) activity levels remain high.

Market figures show that M&A levels went up in the second half of 2010. CFOs clearly expect this trend to continue in 2011.

Despite the financial and political unrest and instability worldwide, the average rate of the AEX-index rose to 363.03 during this first quarter of 2011. CFOs remain optimistic about the AEX index increasing in the next twelve months (78%).

The start of 2011 shows a minor increase in the number of deals. The average value is still low (blue line), but not all deal values of Q1 are yet disclosed.

Where activity levels were low in 2009 and 2010, they are expected to go up in 2011.
China, currently the second largest economy of the world and still growing at a fast rate, is expected to show increased M&A activity within the next years. How will this impact Dutch corporates and their competitive position?

Over 60% of the responding CFOs stated they currently do not have any corporate activities in China. Most of these CFOs are not planning to start activities in China at this point, mostly industry related.

Most of the Dutch companies that are active on the Chinese market reported autonomous growth in China.

Besides China, other countries are considered to be growth areas, too. However, not all growth countries will show increased levels of M&A activity in Europe. Therefore, the CFOs were asked to assess the anticipated Chinese acquisition activities compared with the other BRIC and Asian countries.

India is considered to be an equivalent to China when it comes to acquisition activities in Europe. Other growth countries, such as Brazil, Russia or the other Asian countries, are considered to be less involved in M&A in Europe.
Chinese companies have to learn about the European way of doing business when dealing with takeovers. Chinese companies are expected to increase their M&A activities in Europe. Therefore, European companies should prepare themselves strategically to effectively compete with Chinese companies in making deals.

Even if companies think that increased Chinese M&A activity will not affect their company, larger corporates should realize that whenever they contemplate buying companies in their supply chain or tender for a contract in the near future, they will increasingly be in competition with interested Chinese parties.

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Chart 13. Assessment of Chinese takeovers in Europe: threat or opportunity to your company?
Will increased takeovers in Europe by Chinese companies mainly pose a threat or an opportunity to your company?

Chart 14. Willingness of CFOs to sell company parts to Chinese buyers?
If you contemplate selling some company parts within the next years, would you consider a Chinese company to be a serious buyer?
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 2011 Q1 survey took place between 23 March and 19 April. A total of 37 corporate CFOs, representing a net turnover per company of approximately EUR 1.8 billion, completed our survey. The responding companies can be categorized as follows: less than 100 million (8%), 100 – 499 million (41%), 500 – 999 million (16%), 1 – 4.9 billion (24%), more than 5 billion (8%), unknown (3%).

The participating CFOs are active in a variety of industries (Retail / Wholesale, Manufacturing Technology Real Estate, Consulting, Communication, Energy & Utilities, Transport, 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 it provides you with an important benchmark to understand how your organization rates among your peers.