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The Deloitte/SEB CFO Survey

Closing the Gap

Spring 2014

Contents

Welcome to Deloitte/SEB CFO Survey Spring 2014

We are excited to present the spring 2014 results of the new Deloitte/SEB CFO Survey. The report uniquely combines perspectives from CFOs within large and mid-sized companies in Finland with viewpoints from SEB's Nordic Outlook, the SEB research team's flagship report on key forecasts and global economic trends.

We hope that you find the results and our analysis both stimulating and valuable. Please send us your feedback together with any suggestions for improvements.

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Summary: Closing the Gap

The spring 2014 results of the Deloitte/SEB CFO Survey signal that **the ailing outlook for the Finnish economy is not discouraging chief financial officers from building finally a healthy growth appetite**. The number of CFOs prioritizing defensive business strategies such as cost-cutting is declining and more of them are looking to expand in the next 12 months with a little support from international investments. The change of pace closes the two-year-long gap between defensive and expansionary business strategies, making expansion equally as appetizing as defending the current financial position.

The roadmap for growth is fueled by improving financial status and increasing cash flow. Cash flow is by far the most important source of funds before bank credit, bond issues, and new share issues. The low interest in new share issues is noteworthy—after all, stock markets are running high and for CFOs Finnish companies are mostly either highly or fairly valued. Notably, companies can easily raise funds with bank credit as the lending attitudes of financial institutions have continued to ease. However, companies with a turnover smaller than EUR 500 million do not enjoy the same access to these institutions as their larger counterparts in the same industry.

CFOs are more confident that their financial prospects are going to be better than it was assumed six months ago. According to the survey, CFOs are also willing to tolerate and take more risks on their balance sheets. However, the survey is not all good news. In spite of the boost in optimism, external uncertainty keeps CFOs concerned over the development of demand and the Finnish economy.

The macro outlook indicates that growth is hindered by structural problems that reinforce economic weakness and depress growth and the labor market. Currently, households are also squeezed by rising unemployment, low pay increases, and tax hikes. Because of falling exports, idle capacity, and weak demand, businesses are hesitant to invest. The declining willingness to invest in Finland is troubling as some of the capital that could be invested here will flow abroad. In particular, the growth of the Finnish economy is held back by the weak export sector, which has lost ground in comparison to Sweden.

The results point out three factors that should be monitored by CFOs, economists, and political decision-makers. First, the crisis in Ukraine is forcing CFOs to seek growth from markets other than Russia as country risk increases. Secondly, companies fuel growth and investments preferably with cash. Thirdly, the question is whether the Finnish economy will continue to underperform in comparison with Sweden and the Eurozone. Unemployment in Finland is already increasing and investments are likely to be targeted outside of Finland.

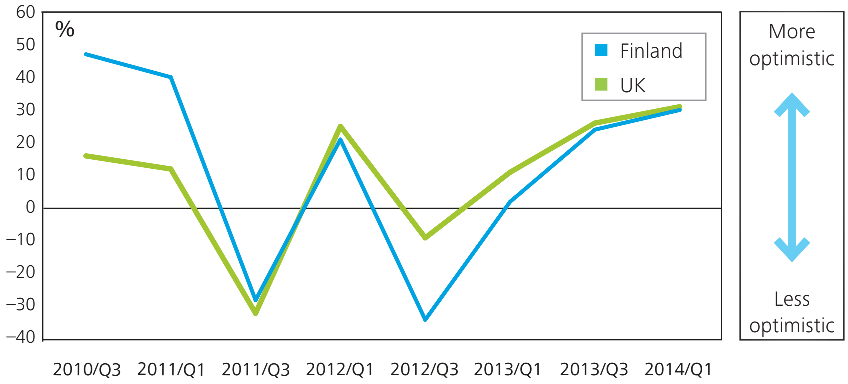
KEY FINDINGS:

- **Closing the Gap:** for the first time in a year-and-a-half an equal number of CFOs are prioritizing expansionary business strategies as defensive ones.
- **Financing fragile growth from internal sources:** increasing cash flow will be the primary source of funding for 91% of companies as they are taking more confident steps on the path towards growth.
- **High valuation of companies does not stimulate equity market activity:** although the perception of the valuation of Finnish companies is at its highest in a year and a half and the equity market can provide adequate financing, 79.7% of CFOs see interest in new share issues decreasing.
- **The most considerable changes in the greatest concerns of CFOs are**: country risk in Russia climbs by 134%, becoming one of the greatest concerns for 20% of CFOs. Similarly, worry over exchange rates has leapt by 120%. However, they fall short of reaching the significance of the concerns over demand and the outlook for the Finnish economy.
- **Willingness to invest exists, but not in Finland:** companies are willing to make strategic and financial investments abroad, but the number of CFOs most willing to make strategic investments in Finland has fallen by 37%.
- **The formula for growth:** prefer to improve your financial status with new product introductions and organic growth and be ready for some prudent investments and acquisitions.
- **Retail/wholesale industry in unrest:** the uncertainty of the retail and wholesale industry edges some of the optimism.
- **The number of employees in Finland still falling in many companies:** 38% of respondent companies are going to reduce the number of employees working for them in Finland.
- **M&A market expected to stay active:** 62% of CFOs suggest activities will increase.

Business Confidence

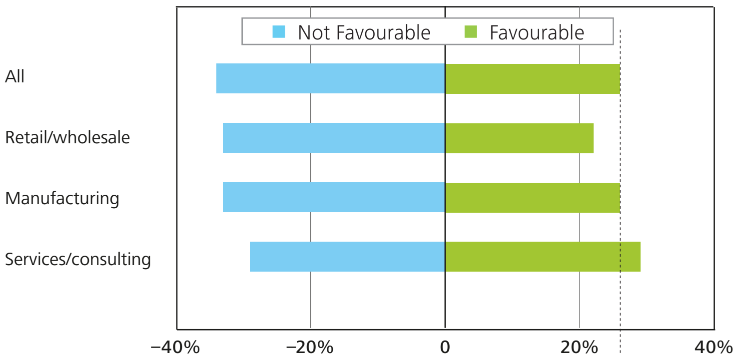
CFO optimism in Finland reaches the levels of the UK where the appetite for risk is at a record high[1]. Maintaining the optimistic trend from last year would allow Finland to reach a four-year record level of confidence. The net percentage of CFOs who are optimistic outweighs those who are pessimistic by 30%.

Compared to six months ago, how do you feel about the financial prospects for your company?



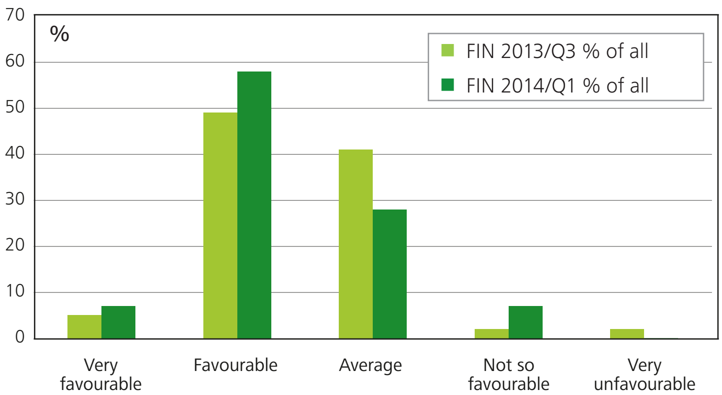
The data suggests that there is a greater divide between those companies that can be expected to perform well and those companies that are expected to perform sluggishly in the coming six months. This concerns especially the manufacturing, retail/wholesale, and services industries where 22—29% of respondents view their business conditions as favorable and 29—33% of respondents reported their conditions to be unfavorable. The retail industry has a slightly softer outlook than other represented industries.

Business conditions for your company in the next six months are seen as:



The ability to create better opportunities for companies to thrive is better than it was six months ago when our survey indicated that companies can only hope for better days. The overall financial position has already improved and 65% of respondents argue that their financial position is favorable.

The overall financial position of your company is seen as:

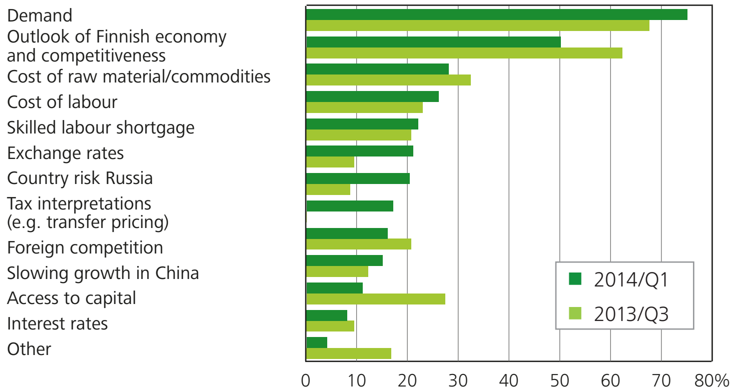


1 *The Deloitte CFO Survey in the UK (http://www.deloitte.com/view/en_GB/uk/research-and-intelligence/deloitte-research-uk/the-deloitte-cfo-survey/index.htm)*

Prospects & Concerns

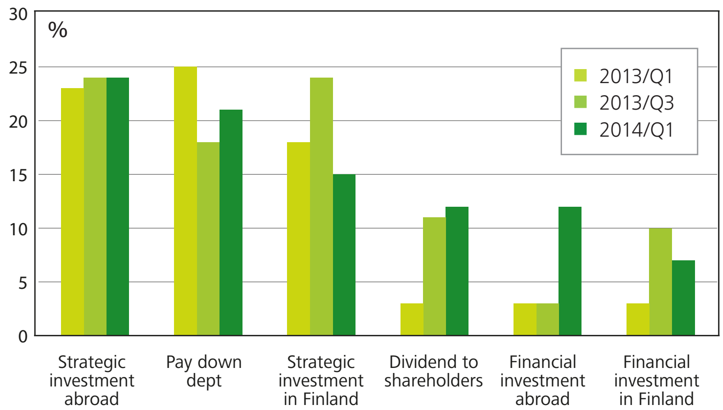
The demand and the outlook of the Finnish economy remain the greatest concerns for Finnish CFOs. Not surprisingly, exchange rate risks (120% increase) and the country risk in Russia (134% increase) have leapt to new levels. Also, stress levels remain high with regard to the costs of raw material and labor.

What are the greatest concerns (most important) for your company in 2014?



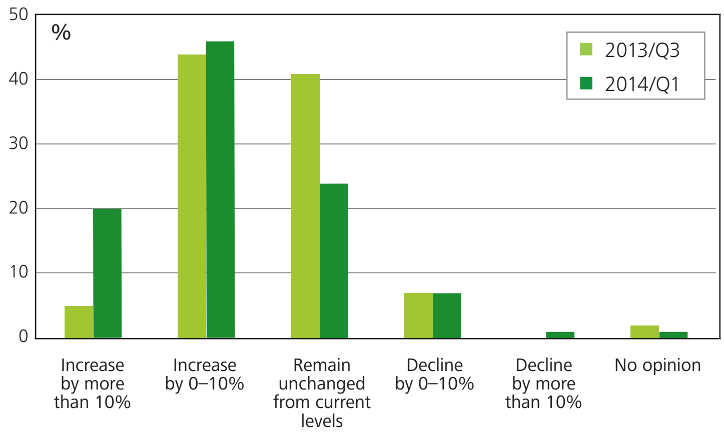
CFOs are still ready to make investments, but with a reduced focus on Finland. The number of CFOs preferring strategic investments in Finland has fallen to 15%, which is 9% lower than it was half a year ago.

Assume a current cash surplus position. How would you prefer to use the money in the next six months?



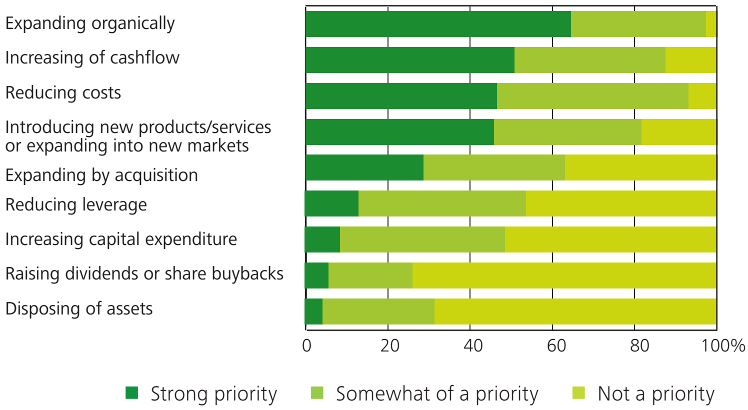
Compared to the last survey conducted after the third quarter in 2013, CFOs are indicating that their companies' ability to improve corporate cash flow is rising. In the third quarter of 2013, fewer than half believed that their companies would be able to do that and now as many as 66% of CFOs expect their cash flow to increase.

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



CFOs have their eyes fixed on cash flow, which keeps the focus on defensive strategies high. However, the defensive trend finally experiences a disruptive fall due to lowered interest in cost reduction. Positively, the focus on expansionary strategies keeps on rising as organic expansion and the introduction of new products or expansion to new markets are even higher on CFOs' priority lists.

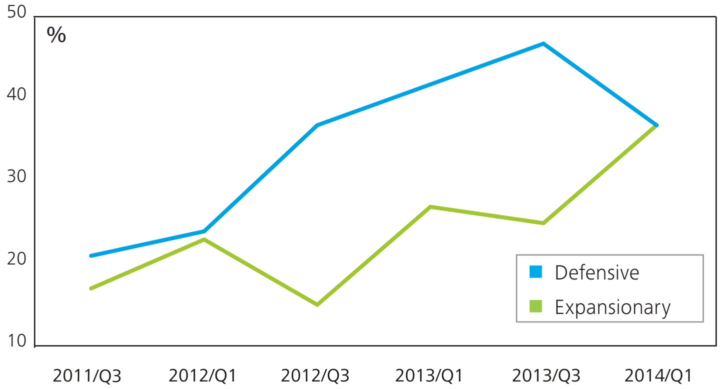
To what extent is each of the following business strategies likely to be a priority for your business over the next 12 months?



Arithmetic average of CFOs who rated expansionary and defensive strategies as a strong priority for their business in the next 12 months.

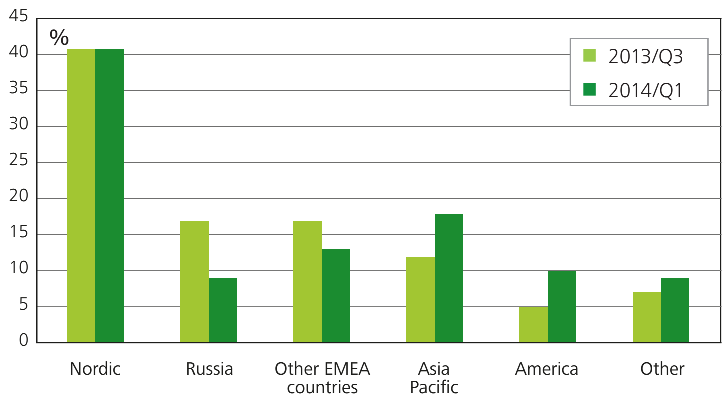
Expansionary strategies are introducing new products/services or expanding into new markets, expanding organically, expanding by acquisition, and increasing capital expenditure. Defensive strategies are reducing costs, reducing leverage, and increasing cash flow.

To what extent is each of the following business strategies likely to be a priority for your business over the next 12 months?



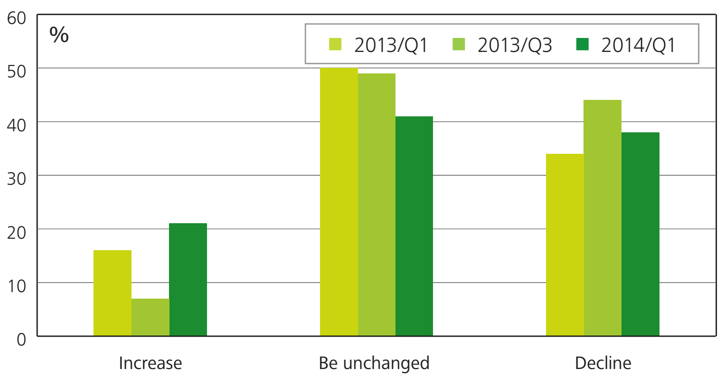
The risks associated with Russia's geopolitical actions are materializing in Russia and in EMEA countries (except the Nordics) as CFOs are shifting their focus from Russia and Europe to Asia-Pacific and America.

During the next 12 months, in what region do you expect your company to have the best opportunities for growth?



Twenty-one percent of CFOs say they will be employing more people in Finland in the coming six months. However, this marginal improvement from the last survey does not have significance in the larger scheme as 38% of respondents are still going to reduce the number of employees working for them in Finland.

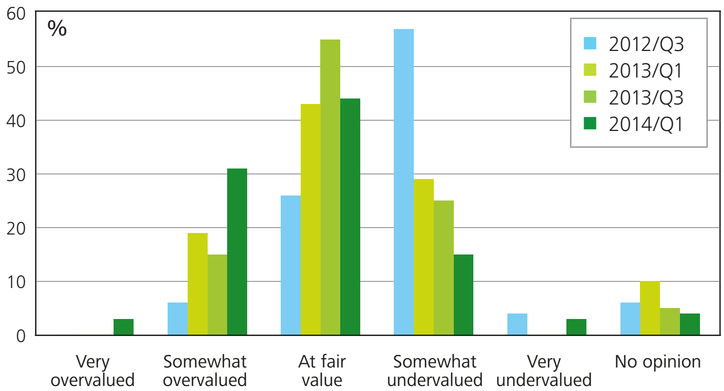
The number of employees working for your company in Finland in the next six months is expected to:



Finance

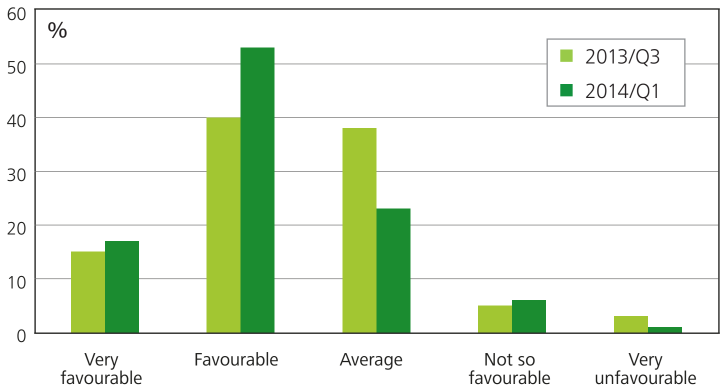
In the opinion of CFOs, Finnish companies are more overvalued than ever within the last two and a half years. Thirty-four percent perceive the valuation of Finnish companies to be above fair value while only 18% regard the valuation of Finnish companies as low. This indicates that it would be a good time to raise new equity in terms of valuation.

How do you currently rate the valuation of Finnish companies?



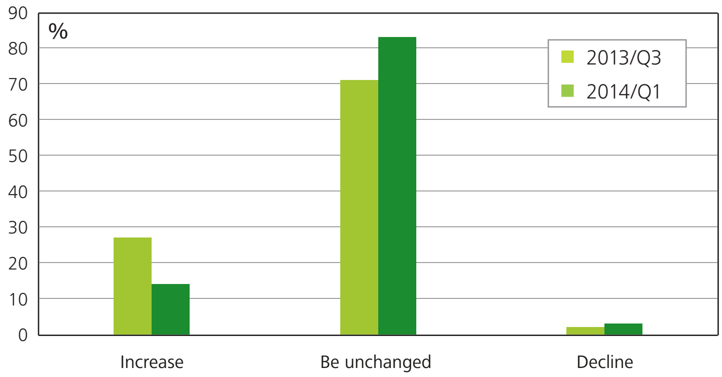
The lending attitudes towards the respondents companies are improving. No company with a turnover of more than EUR 500 million has experienced unfavorable lending attitudes. The 7% of the respondents who returned unfavorable values were companies with a turnover less than EUR 500 million. These companies might be turning to the wrong financing sources as they might be a target for private equity firms and large Finnish companies who actively seek new ideas on how to use their cash surplus[2].

The lending attitude of financial institutions towards your company is seen as:



The probability of counterparties defaulting is now marginally more stable than it was six months ago. The percentage of CFOs who assume the default risk will increase has been cut to almost half. Stability is yet another factor strengthening CFOs' confidence that their companies' financial status might just start improving.

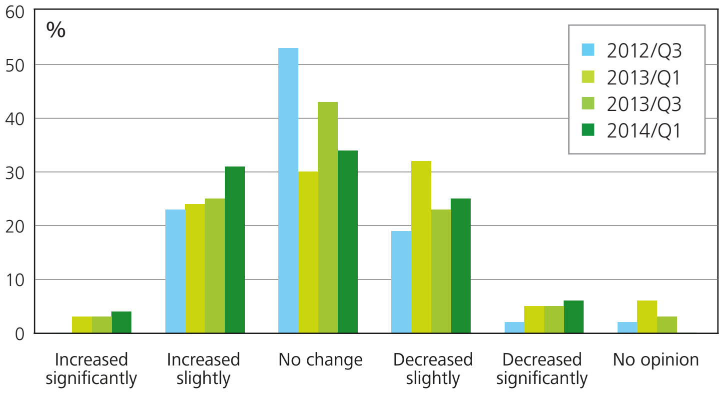
The probability for counterparties to default in the next six months is expected to:



2 *Deloitte M&A Barometer: http://www.deloitte.com/view/fi_FI/fi/ajankohtaista/lehdistotiedotteet/2c3267d2dc245410VgnVCM3000003456f70aRCRD.htm*

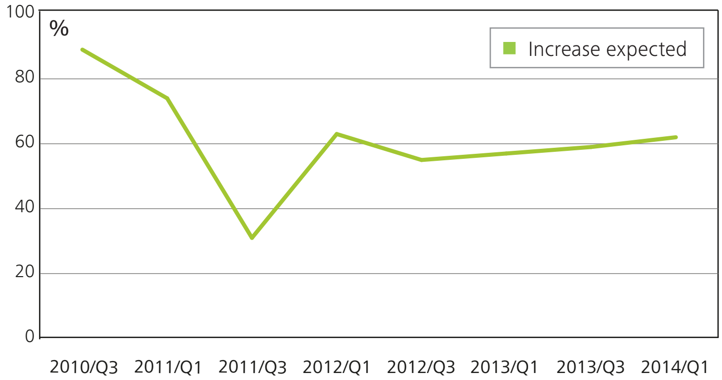
Since the third quarter 2013, deviation with an increased risk on the balance sheet and a decreased balance sheet risk is once again increasing. Thirty-five percent of CFOs are witnessing increased risks and 31% are witnessing decreased risks. One external factor increasing risks might be the exchange rate sensitivity due to the crisis in Ukraine. Additionally, our previous analysis showed that companies are still maintaining their investment activities and CFOs are ready to finance that with bank credit, increasing the level of gearing, and making companies more vulnerable to interest rate sensitivities.

How has the level of financial risk on your balance sheet changed over the last 12 months?
(Financial risk could include, for instance, levels of gearing, uncertainty about the valuation of assets and interest rate and exchange rate sensitivity.)



Two thirds of the respondents insist that the M&A market will stay active. CFOs are almost as encouraging with their predictions as M&A specialists, of which 70% believe that they are going to be involved in a merger or an acquisition in the next six months[3]. Notably, only 11% of respondents argued that acquisitions and divestments are going to decrease. Those respondents who represented retail/wholesale and service/consulting industries gave, on average, a higher probability for increasing M&A activity.

Percentage of CFOs expecting the acquisition and divestment activities to increase over the next 12 months:

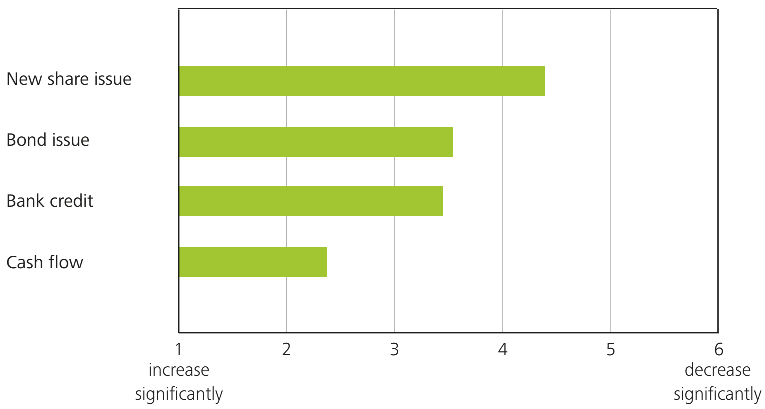


Hot Topic

Increasing equity capital is not within the scope of CFOs in the coming 12 months. To be accurate, 79.7% of CFOs see interest in new share issues declining. Also, 53.1% of CFOs suggest that issuing corporate bonds is not in their plans in the foreseeable future. The majority of CFOs see the importance of bank credit and cash flow increasing. The increased importance of both might be due to a stronger positive attitude from financial institutions towards the respondent companies and the ability to improve sales or effectively utilize other methods that improve cash flow.

A small majority (54.5%) are giving more weight to bank credit, but the vast majority (91%) see the importance of cash flow growing.

How will the importance of the following financing sources for your company change over the next 12 months?
(Average 1 = increase significantly, 6 = decrease significantly)



3 *Deloitte M&A Barometer:*
http://www.deloitte.com/view/fi_FI/fi/ajankohtaista/lehdistotiedotteet/2c3267d2dc245410VgnVCM3000003456f70aRCRD.htm

Macroeconomic Context
Exports Holding Back Growth

Finnish economic growth is the weakest in the Nordic region. We expect GDP to climb weakly: by 0.2% this year and 1.4% in 2015. For the Nordic region, our respective estimates are 2.0% and 2.4%. Structural problems are reinforcing economic weakness, depressing growth and the labor market. Households are being squeezed by rising unemployment, low pay increases, and tax hikes. Because of falling exports, idle capacity, and weak demand, businesses are hesitant to invest.

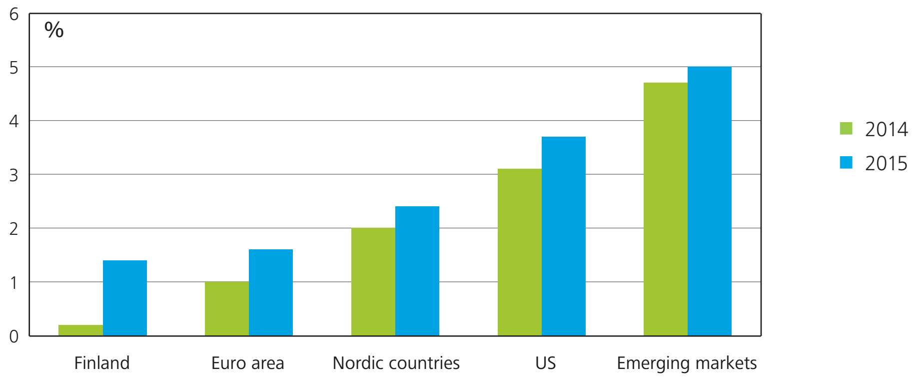
A weak economy and idle resources lead to low capital spending. Capital spending has fallen two years in a row, yet capacity utilization is low. Still, due to pent-up capital spending needs, business investments will slowly get underway towards the end of 2014. Total capital spending is estimated to increase by 0.5% in 2014 and 2% in 2015.

Production and exports remain squeezed and have fallen in the past year. Compared to 2008, Finnish exports as a share of GDP have fallen by nearly 10 percentage points. Net exports have provided a negative growth contribution averaging 0.7 percentage points since 2008, but recently imports have fallen more than exports and net exports have begun contributing positively to growth. A comparison with Sweden, another export-dependent country, illustrates clearly how Finnish exports have lost ground. Finland's decline was deeper in 2008—2009 and its recovery has not been as strong.

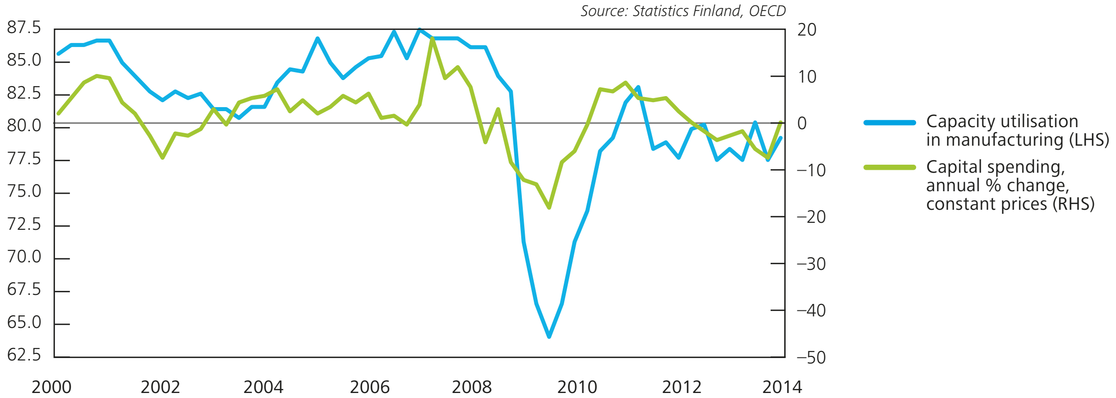
Households are being squeezed. Finland's once relatively resilient households are now being squeezed from several directions. Unemployment is rising, fiscal policy austerity has included value added tax (VAT) hikes, pay increases have decelerated, and the housing market is shaky. Because of below-trend economic growth, unemployment will continue to rise before turning downward in 2015. Measured as annual averages, unemployment will be 8.5% in 2014 and 8.3% in 2015. So far, the upturn in unemployment has been due to a rising supply of labor, while the number of jobs has only fallen marginally (by 4,000) in the past year.

Wage hikes and inflation on their way down. The collective labor agreements signed in 2013 represent a

GDP growth estimated for different countries



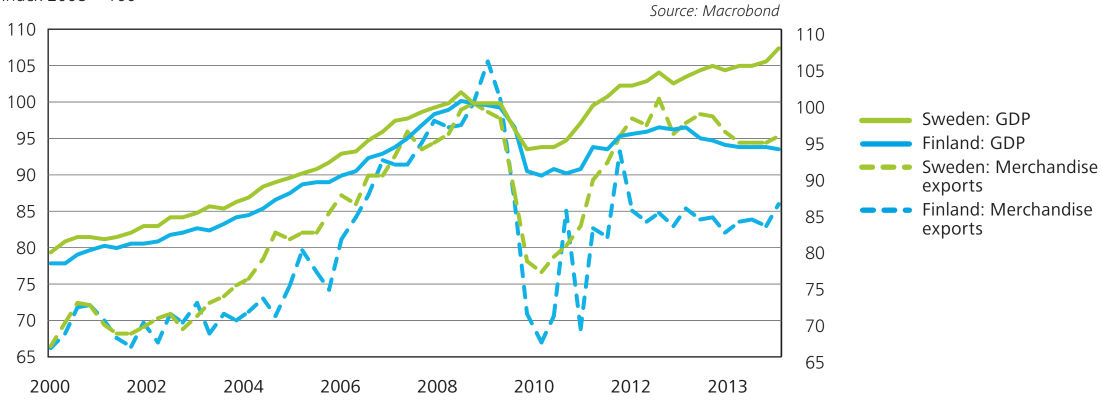
Capacity utilisation and capital spending



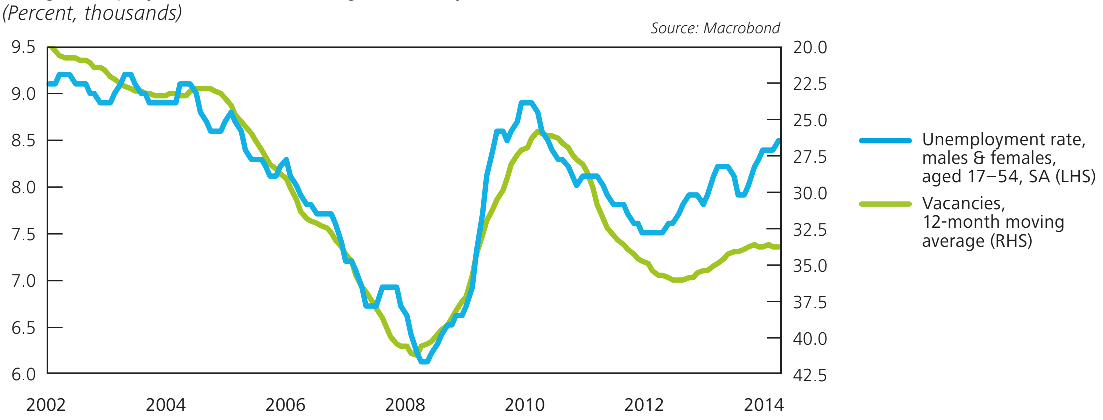
slowdown in the rate of pay increases in 2014—2015 compared to 2012—2013. This will benefit Finland's competitiveness, but, at the same time, it means household income growth will be weaker. Wages and salaries are estimated to climb by a bit over 2% annually in 2014 and 2015. Despite increases in VAT and other indirect taxes, inflation is falling. The impact of tax hikes seems to be somewhat less than initial estimates indicated; in the prevailing environment, companies are having a hard time raising consumer prices. HICP inflation is estimated to increase by 1.6% and 1.7% annually in 2014 and 2015, respectively, which means that real wages will rise slightly during our forecast period.

Finland is still among a shrinking category of countries with the highest credit rating. Despite the fact that S&P recently revised its outlook on Finland from Stable to Negative, Finland has avoided breaking any fiscal rules of the European Union and maintained low bond yields. The government bond yield gap to Germany has been stable at 20—30 basis points during the beginning of the year, which is in line with the previous year.

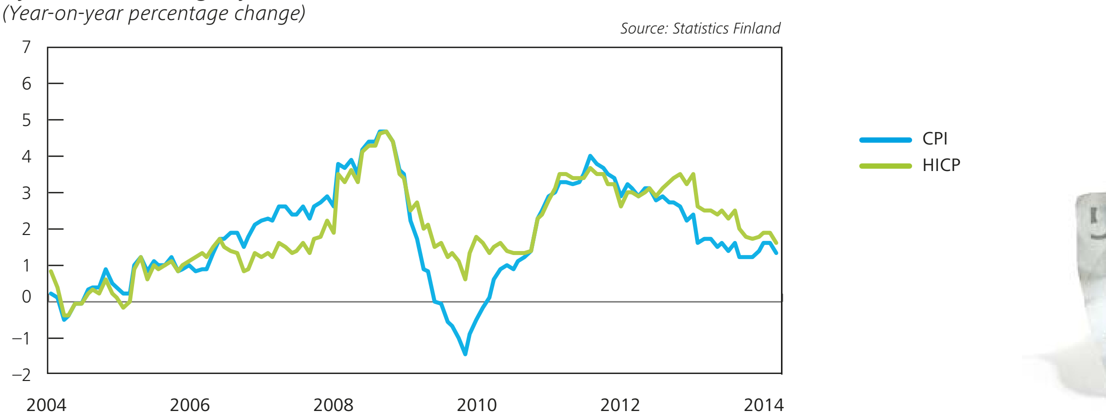
Lack of export recovery points to structural downturn
Index 2008 = 100



Rising unemployment and decreasing number of vacancies
(Percent, thousands)



Inflation is continuing to fall
(Year-on-year percentage change)



About the Survey

This is the first-quarter edition survey of Chief Financial Officers and Groups Finance Directors in Finland. The survey is published twice a year—soon after the first and third quarters. It is the only survey that reflects CFOs' attitudes to the operating environment, valuation, risks, funding, and expectations.

The survey is carried out as a web-based questionnaire. The 2014 first-quarter survey took place between March 18 and April 1. Seventy-one CFOs participated, including a good mix of privately held and publicly listed medium, large, and multinational companies across a broad range of industries. This quarter, manufacturing, retail and wholesale, and service industries were in the majority. Sixty percent of respondents are from companies that have an annual turnover of more than EUR 200 million. Twenty-three percent had an annual turnover of more than EUR 1.5 billion.

Writers & Contributors

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Please visit www.deloitte.fi for the latest and past copies of the survey and other publications.

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Read more about SEB at http://www.sebgroup.com.