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The Deloitte/SEB CFO Survey Back to Basics

Fall 2014

Welcome to Deloitte/SEB CFO Survey Fall 2014

We are excited to present the fall 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.

Soon after our previous survey in the spring we experienced some dramatic changes in the pan-European geopolitical balance of power that has also had a significant impact on the ability to seek growth from Russia due to the tightened trade sanctions. This has also impacted the results of our current survey. However, the business conditions are not all that bleak as most readers might expect.

The impact of the current events and the CFOs' uncompromised attitudes on their own ability to control the risks can be found on the pages of this survey; so we hope that you find the results and our analysis both stimulating and valuable. Please send us all feedback together with any suggestions for improvement.

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Summary

Positively developed business optimism from the past year and a half has dropped to the levels of early 2013 in the fall 2014. Finland isn't experiencing this development alone as CFOs in the UK have given similar indications.

CFOs are experiencing tolerable risks. This might be due to the eased lending attitudes, ability to cope with the geopolitical crisis, and the defensive strategies CFOs are employing. Notably, the lending attitudes of financial institutions are, by some accounts, the most positive ever since the post-financial crisis, although the larger companies still enjoy better access to the institutions compared to their smaller counterparts.

Despite the softer prospects, there is no need to panic while companies are still making targeted strategic investments in Finland and abroad.

Because the financial risks have reduced and operational cash flow is expected to improve, we asked CFOs how they would prefer to use their liquidity if their cash surplus remains the same. CFOs' responses outlined a higher focus on domestic markets. 23% believed that they could make strategic investments in Finland and 17% assumed that they would make those investments abroad.

There is no end to the news related to job reductions. Even though the majority of companies (63%) predict that they can increase their operational cash flow in the next 12 months, this won't translate into a greater willingness to hire. There are still significantly more companies that are cutting their workforce than those who are hiring new employees. This indicates that the barriers constraining the development of the Finnish economy have not been overcome.

Macroeconomically the recession is over, but weak demand and concerns over the development of it are hindering growth opportunities.

The end-2013/early-2014 recession ended earlier than expected when second quarter growth came in at 0.2%. However, we do not expect much in terms of positive news from the Finnish economy during the rest of 2014. The outlook is still weak and the economy is troubled by structural problems and a high exposure to Russia compared to other Western European countries.

KEY FINDINGS:

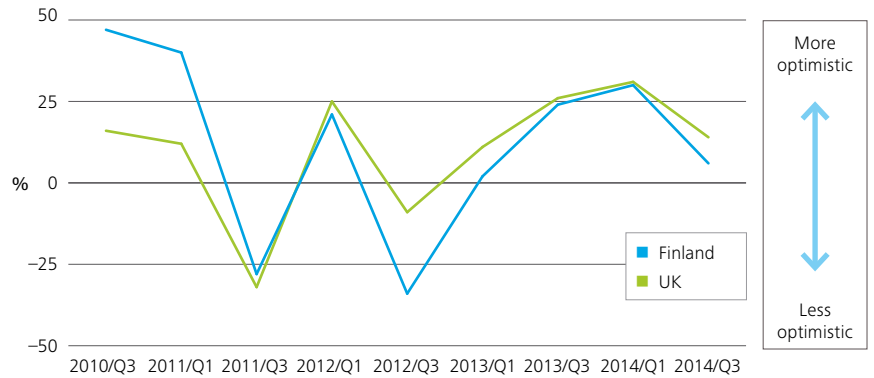
- **CFOs are turning significantly more cautious:** 31% of CFOs are prioritizing growth strategies, which is six percentage points less than six months ago.
- **Net Business optimism** has fallen from 30% to 6% in six months.
- **71% have good access to loans** and other non-equity related capital.
- **63% of respondents will be able to increase** their operational cash flow in the next 12 months.
- **43% of CFOs are reducing the number of employees** working for them in the next six months.
- **37%** of the respondents say that the geopolitical crisis will reduce their revenues.
- **23% of CFOs are willing to make strategic investments in Finland** if the liquidity remains the same, which Deloitte and SEB assumes to be quite probable.



Business Confidence

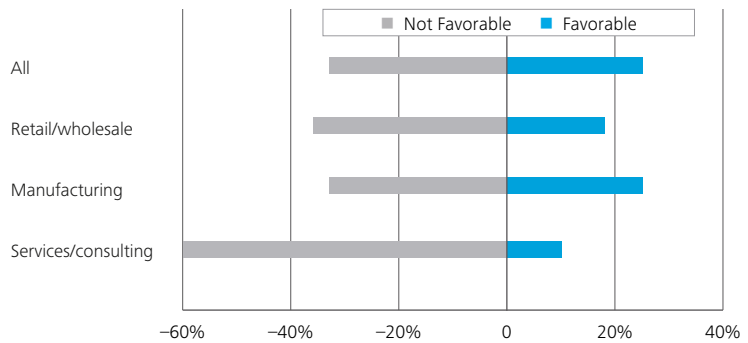
The rapid increase in general business confidence has ended and the absolute net optimism has fallen by 24 percentage points from the last spring. However, there still are more CFOs' who feel that their financial prospects are better than six months ago. The net percentage of CFOs who are optimistic outweighs those who are pessimistic by 6%. Furthermore, it can be noted that despite the size of the markets, the financial prospects in Finland and UK seem to be similar.

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



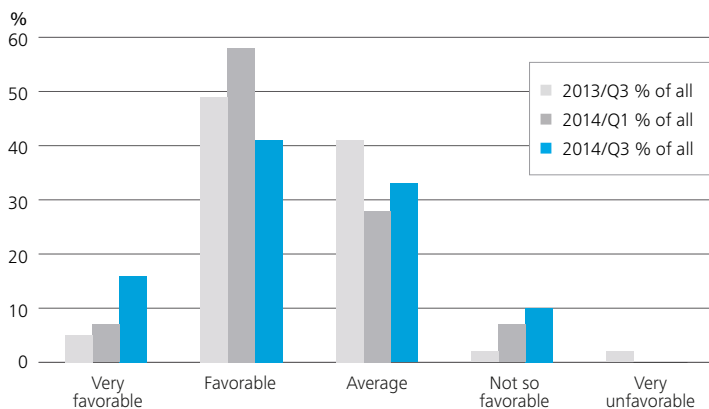
The business conditions have remained generally the same. 25% are seeing the conditions favorable while 33% are expecting unfavorable conditions. Compared to our previous survey, the biggest change in business conditions can be seen in services and consulting industry. At the moment, even 60% of the services and consulting representatives see their business conditions unfavorable. Surprisingly the manufacturing industry has a softer outlook than other represented industries.

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



More of the CFOs in Finland have been able to manage their financial risks. 57% of the respondents see their position as either favorable or very favorable. From the spring 2014 survey, the "very favorable" alternative has increased, while the share of CFOs choosing the "favorable" alternative has diminished. Based on this, we could argue that rather large share of respondents is apparently satisfied with their company's financial position.

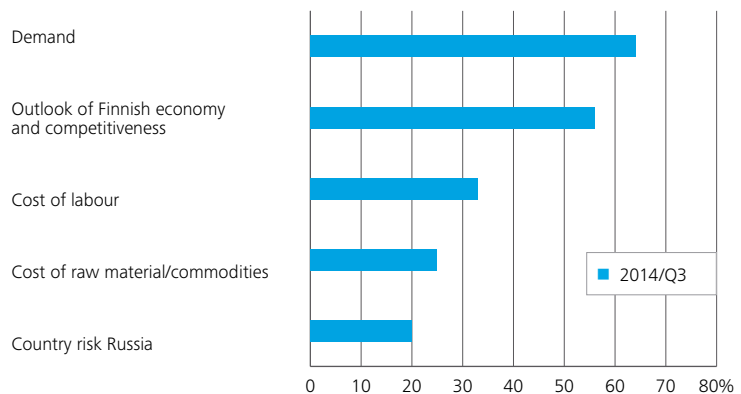
The overall financial position of your company is seen as:



Prospects & Concerns

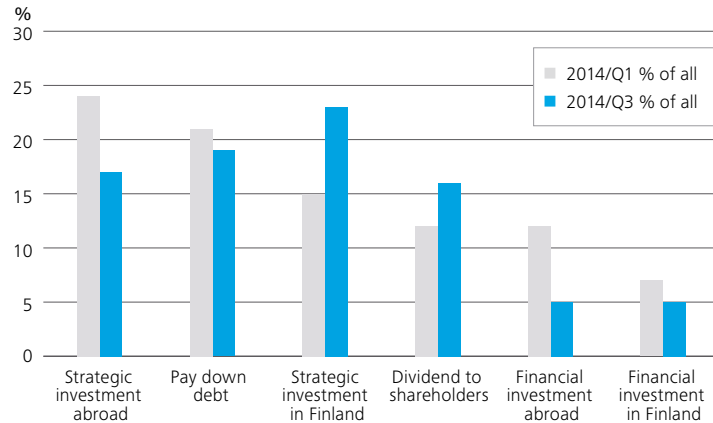
The same worries over demand, the outlook for the Finnish economy, and the cost of labor and raw materials continue as the greatest concerns among Finnish CFOs. The changes in the geopolitical crisis in Ukraine and the hardening EU sanctions have not had a negative impact on the levels of country risk Russia. The risk level has remained roughly the same (20%) since our previous survey. Also, the concern over tax interpretations doesn't significantly worry CFOs while only 7% view it as one of the greatest concerns.

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



Assuming a cash surplus situation, CFOs favour investments over debt reduction or dividends to owners. We could argue that this reflects strong balance sheets and the fact that there are opportunities to invest. More CFOs assert that they would be more focused on their home markets in the coming six months than they were in the spring 2014. For instance, 23% of the respondents assume they would make some strategic investments in Finland.

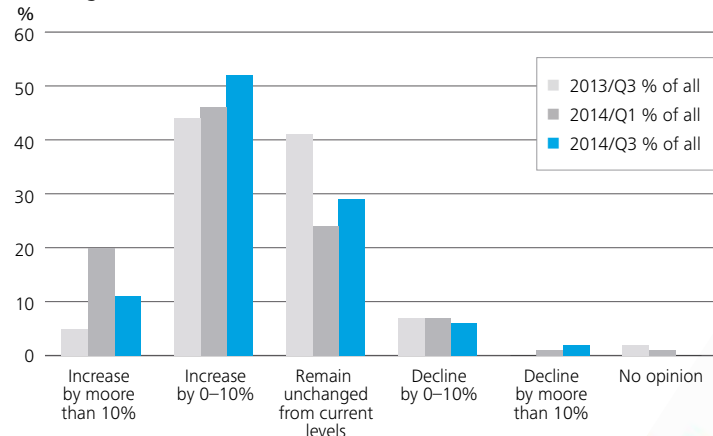
Assume a current cash surplus position. How would you prefer to use the money in the next six months?



23% of the respondents assume they would make some strategic investments in Finland.

Just as with the overall financial position, CFOs' sentiment is rather positive in regard to the development of the operating cash flow. In spite there are not as many CFOs' expecting the highest returns (above 10% cash flow hike), the majority (63%) still assume they are able to improve slightly. However, optimism is not quite as strong as in our previous survey.

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



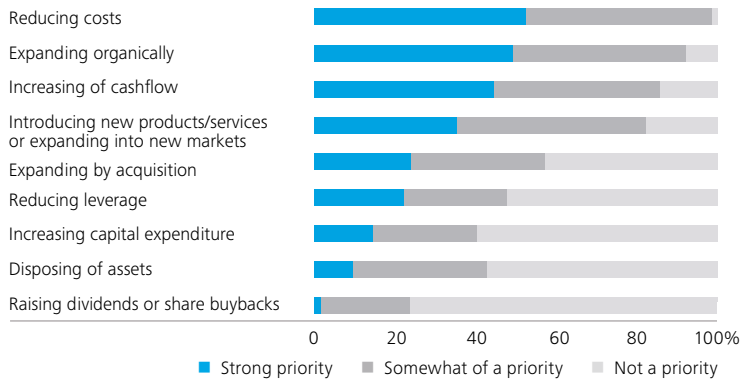
Yet again, CFOs are turning more cautious. Companies have fewer openings to pursue new growth opportunities, which causes reductions in the eagerness to expand. On the defensive side, reducing costs and increasing cash flow have remained as important as they were six months ago.

Defensive strategies are a strong priority for 40% of the CFOs, while expansionary strategies are a strong priority for only 31%.

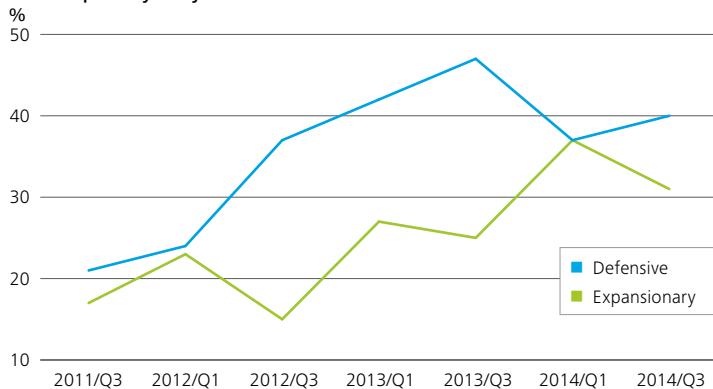
CFOs have their eyes fixed on domestic, Nordic and, to some extent, other EMEA countries. CFOs are inclined to avoid volatile markets in the next 12 months. Especially the perception of Russia as a possible growth market has evaporated, while only 5% of the respondents believe that they have the best opportunities for growth in Russia.

As referred to before, companies are willing to make strategic investments in Finland, but that won't be seen in the level of hiring in the near future. Quite the contrary, 43% of CFOs will be reducing the number of employees working their companies. At the same time, hiring abroad is still continuing to increase while more than double the number of companies are going to hire compared to those that are downsizing.

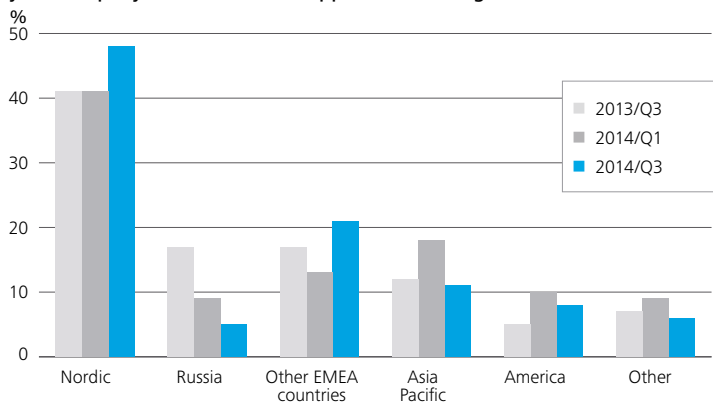
To what extent is each of the following business strategies likely to be a priority for your business over the next 12 months?



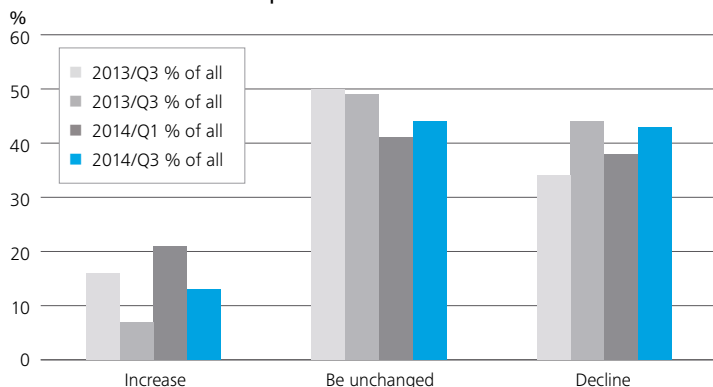
To what extent is each of the following business strategies likely to be a priority for your business over the next 12 months?



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



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

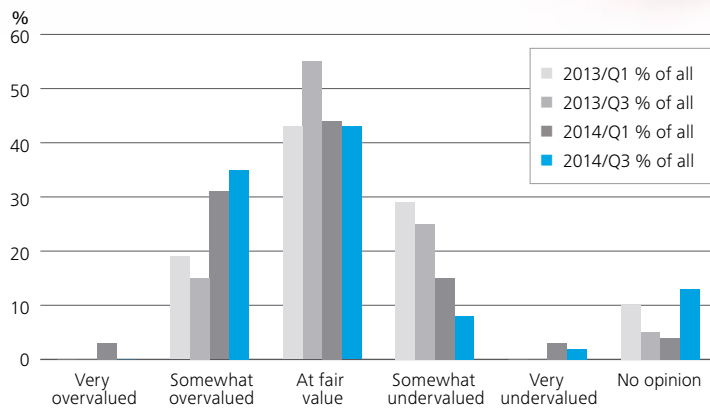


Finance



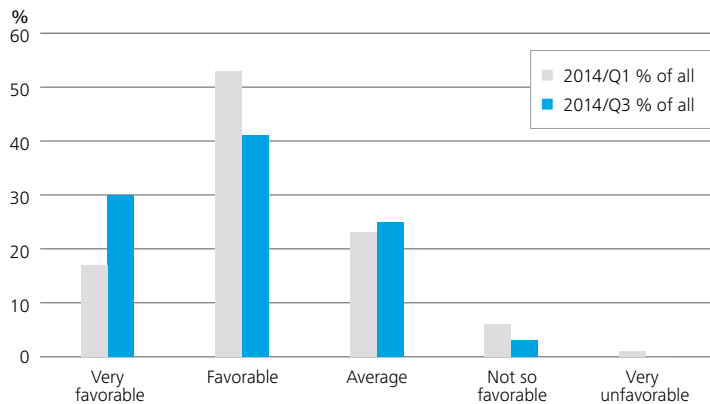
The respondents argue that the valuations of Finnish companies are at fair values (43%) or they are only somewhat overvalued (35%). Based on the responses, it could be argued that the stock markets are not in a bubble.

How do you currently rate valuation of Finnish companies?



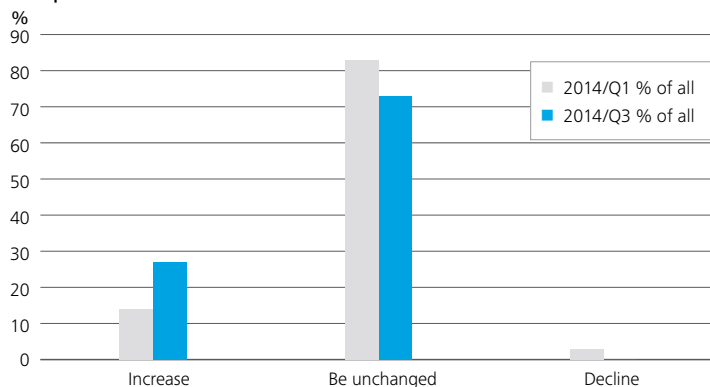
According to our survey, financing is available if appetite to borrow increases. The lending attitudes have been significantly improved and, in our experience, the attitudes are better than ever after the post-financial crisis. 71% of CFOs say that lending attitudes are favorable. In addition, low interest rates make conditions for lending money favorable for companies.

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



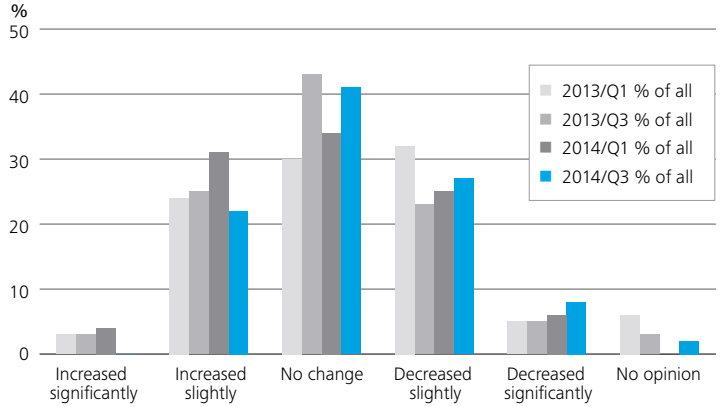
The risk of counterparty default has returned to the trend after a slight default risk decrease from last spring. 27% of CFOs expect counterparty defaults to increase.

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



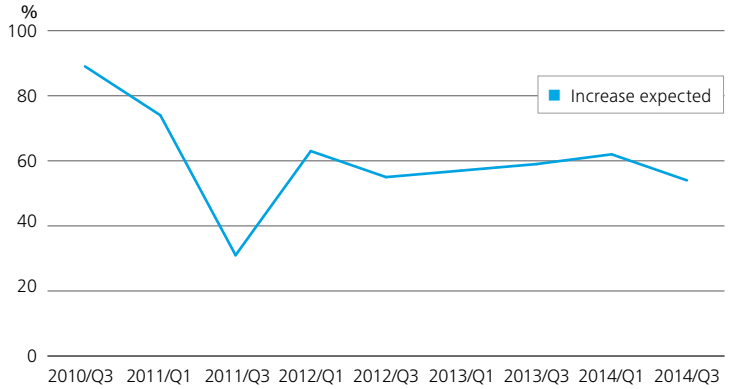
CFOs are experiencing tolerable risks. Risks have remained the same for 41% of the respondent companies and a greater number of respondents have experienced their balance sheet risks decrease compared to the number whose risks have increased.

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.)



The M&A market has been moderately active for the past year and, if the CFOs are to be believed, that trend is expected to continue. The sentiment is slightly less optimistic than before, but other recent surveys (Deloitte M&A Barometer, October 2014) have also indicated that the market is going to maintain the activity levels from the spring.

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

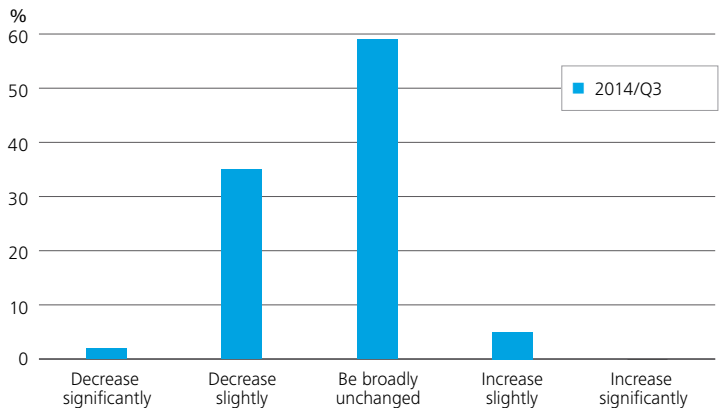


Hot Topic

37% of the respondents will experience their revenues falling due to the crisis. However, the majority will remain unaffected.

The geopolitical crisis is making CFOs cautious in Finland. CFOs are shifting their geographical focus to less volatile markets such as Nordic and other EMEA countries. The crisis will also impact more than one-third's revenues negatively. A relieving indication is that more than half of the companies have been able to adapt to the situation and their business won't be affected by the crisis. Still, CFOs' sentiment seems to some extent go against the notion that the crisis won't have an impact on the development of the Finnish macro-economic environment. Interestingly, the Deloitte SEB CFO survey conducted in Sweden returned even more negative values. Almost 50% of the CFOs surveyed in Sweden believe that the geopolitical unrest will have an impact on their business negatively.

How will the geopolitical crisis affect your company's revenues?



Macroeconomic Context

Broad-based Weaknesses

Even though the recession is over, a weak domestic economy together with low demand in Eastern and Western Europe will contribute to slower growth than the Nordic averages. In the second half of 2014, growth will be zero or marginally positive on a quarterly basis. Measured as annual averages, GDP will fall by 0.3% in 2014 and grow by a meagre 0.5% in 2015 and 0.9% in 2016.

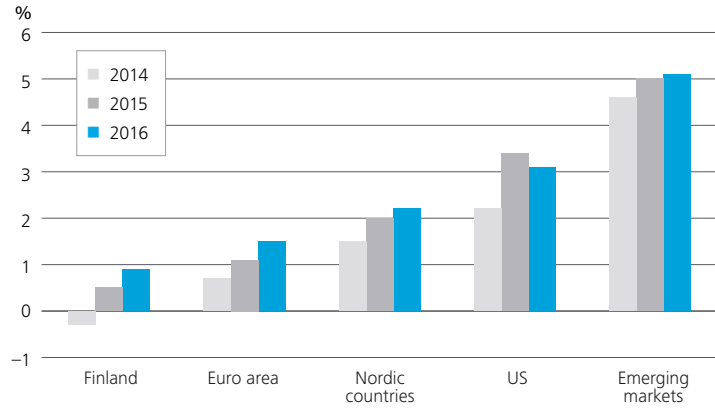
Several weak signs in the near term. Indicators have fallen from low levels to even lower. To some extent, this is probably due to worries related to geopolitical tensions, but the details are worrying. Industry has been weak but what we are now seeing is that previously more resilient domestic portions of the economy have lowered their outlook. The Economic Sentiment Indicator (ESI) fell sharply in September with the largest declines in the service and construction components.

Manufacturing production declined by 3.5% in July and has fallen for two years, although the trend is that the

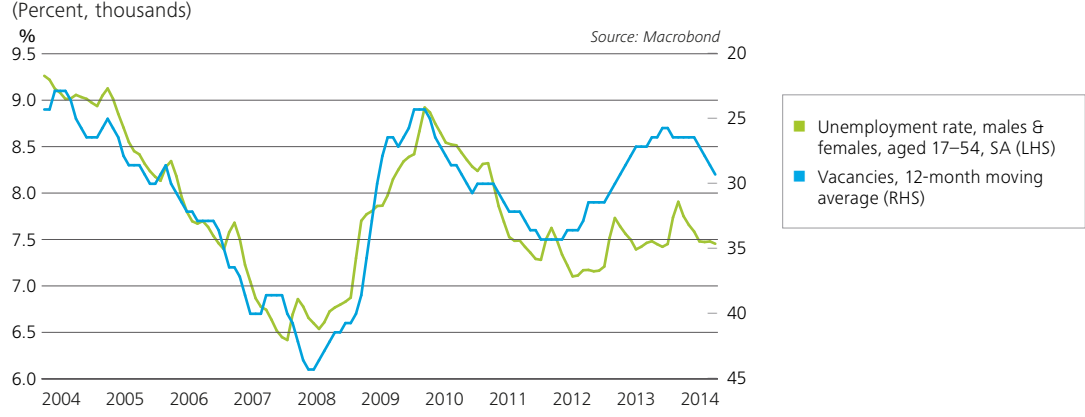
decline is getting increasingly smaller. Exports are also weak but since imports fell at a faster pace, net exports made a positive contribution to growth. This trend is expected to continue for the rest of the year.

Finland's exports total less than 40% of GDP. Russia is Finland's third largest trade partner (after Sweden and Germany). Nearly 10% of exports go to Russia. EU-Russian trade sanctions thus have a relatively large impact on the Finnish economy; for example, Russia buys nearly 20% of Finnish food exports. Exports to Russia are weak, due to both the continuing economic slowdown in Russia and more recent geopolitical turbulence. Exports to Russia started to fall as early as the third quarter of 2013, and, so far this year, the decline is slightly above 10% on an annual basis. It is hard to quantify the impact of Russia's import restrictions, but a 25% downturn in total exports would lower GDP by more than 1%. In addition, there are negative spill-over effects, but, in practice, these are usually offset as exports find new markets.

GDP growth estimated for different countries



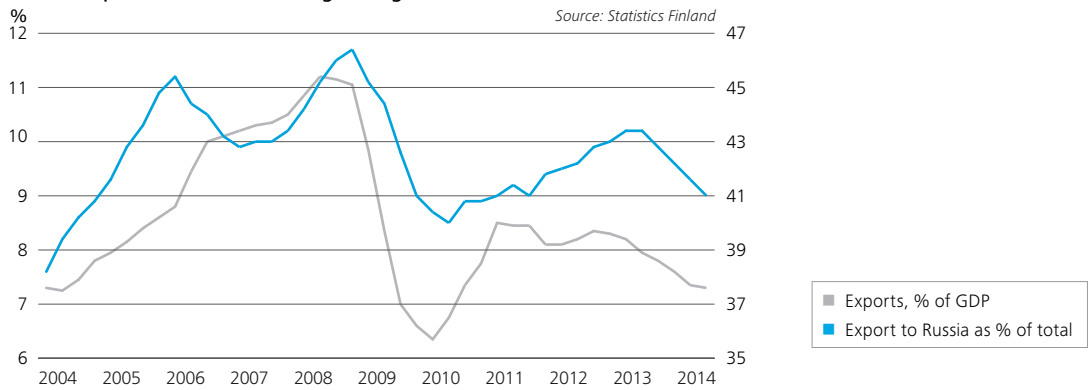
Rising unemployment and decreasing number of vacancies



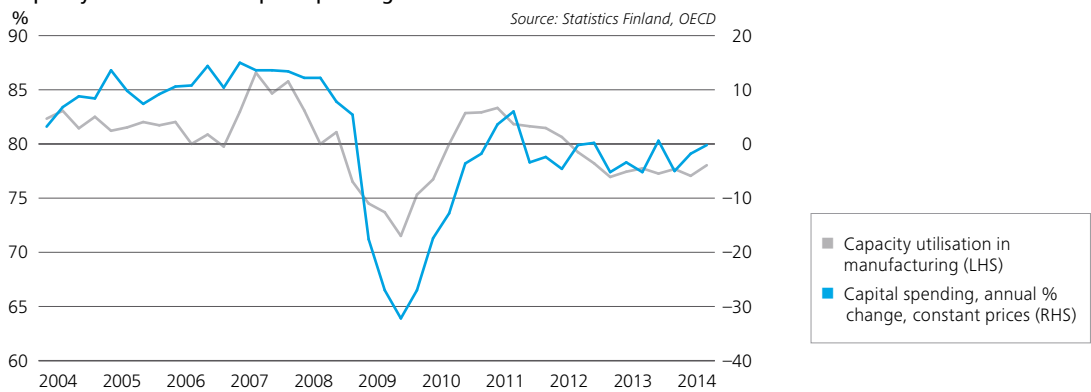
Low capacity utilization and low confidence among companies indicate that capital spending data will remain weak. Falling house prices are contributing to weak residential investment as well. We expect capital spending to fall by almost 2% in 2014.

Inflation has fallen significantly and was 1.2% in August. Downward pressure will continue, since internal and external demand is low while the economy has a lot of spare capacity and wage increases are low. We estimate HICP inflation will be 1.2% in 2014 and 1.0% in 2015 and 2016.

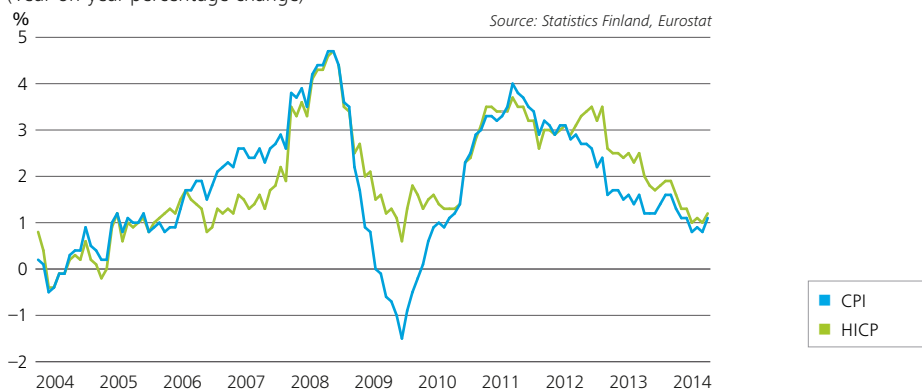
Finnish exports, 12-month moving average



Capacity utilisation and capital spending



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



About the Survey

This is the third-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 quarter. It is the only survey that reflects CFO attitudes to the operating environment, valuation, risks, funding, and expectations.

The survey is carried out as a web-based questionnaire. The 2014 third-quarter survey took place between September 16 and October 3, 2014. Sixty-three 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 & wholesale and service industries were in the majority, which has been the trend throughout the history of the survey. 54% of the respondents are from companies that have an annual turnover of more than 500 million euros. 22% had an annual turnover of more than 1.5 billion euros.

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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