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CFO Survey

Europe | 2019

Q1

In Focus

Special Edition Survey on Corporate Financial Planning

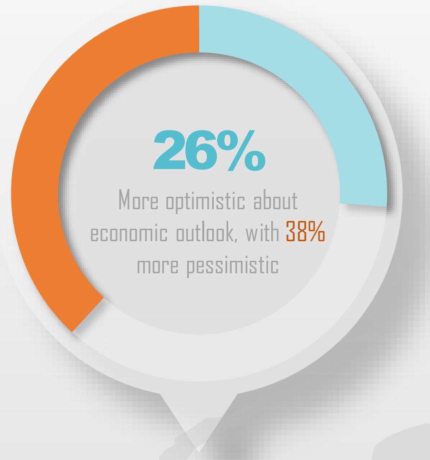
May 2019

CFO optimism Q1 2019

Economic sentiment among European CFOs

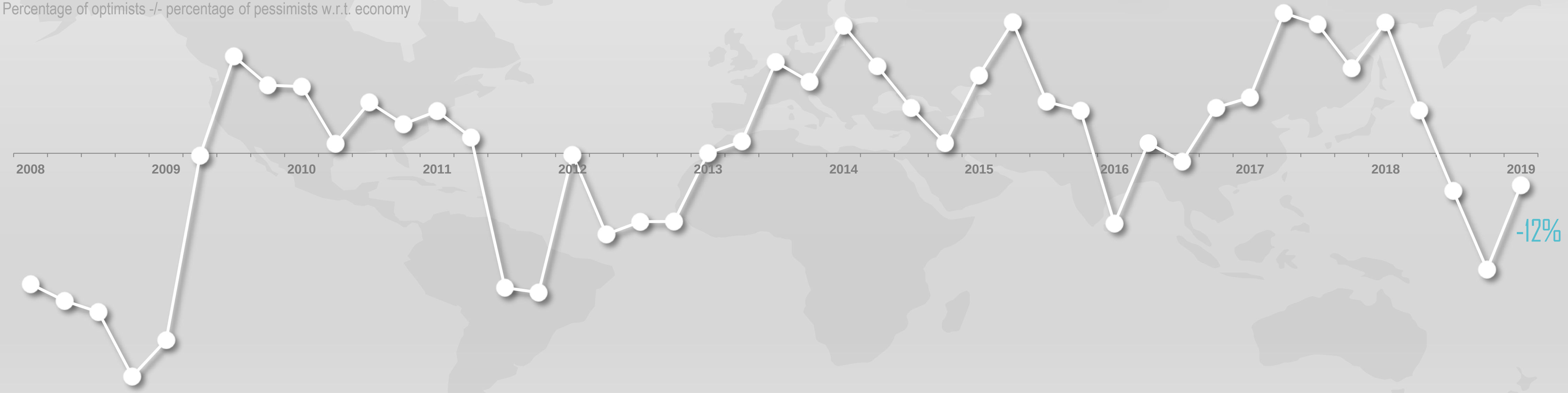
Optimism among European CFOs has improved considerably during the first quarter of 2019. The share of optimists among European CFOs who have a positive outlook on the economy of their own country has increased to 26%, up 15% from Q4 2018. European CFOs rate their own economy at an average score of 59.5 on a scale of 100, breaking the downward trend that we observed during the previous four quarters.

Compared to other major economic regions such as the US (64/100), Latin America (65/100), and Asia (65/100), the economic sentiment among European financial executives remains rather subdued. In these same regions we also see a much higher share of optimists among the CFOs, ranging from 24% in the US, to 47% in Asia and even 66% in the Latin American territory.



European CFO optimism index (QoQ)

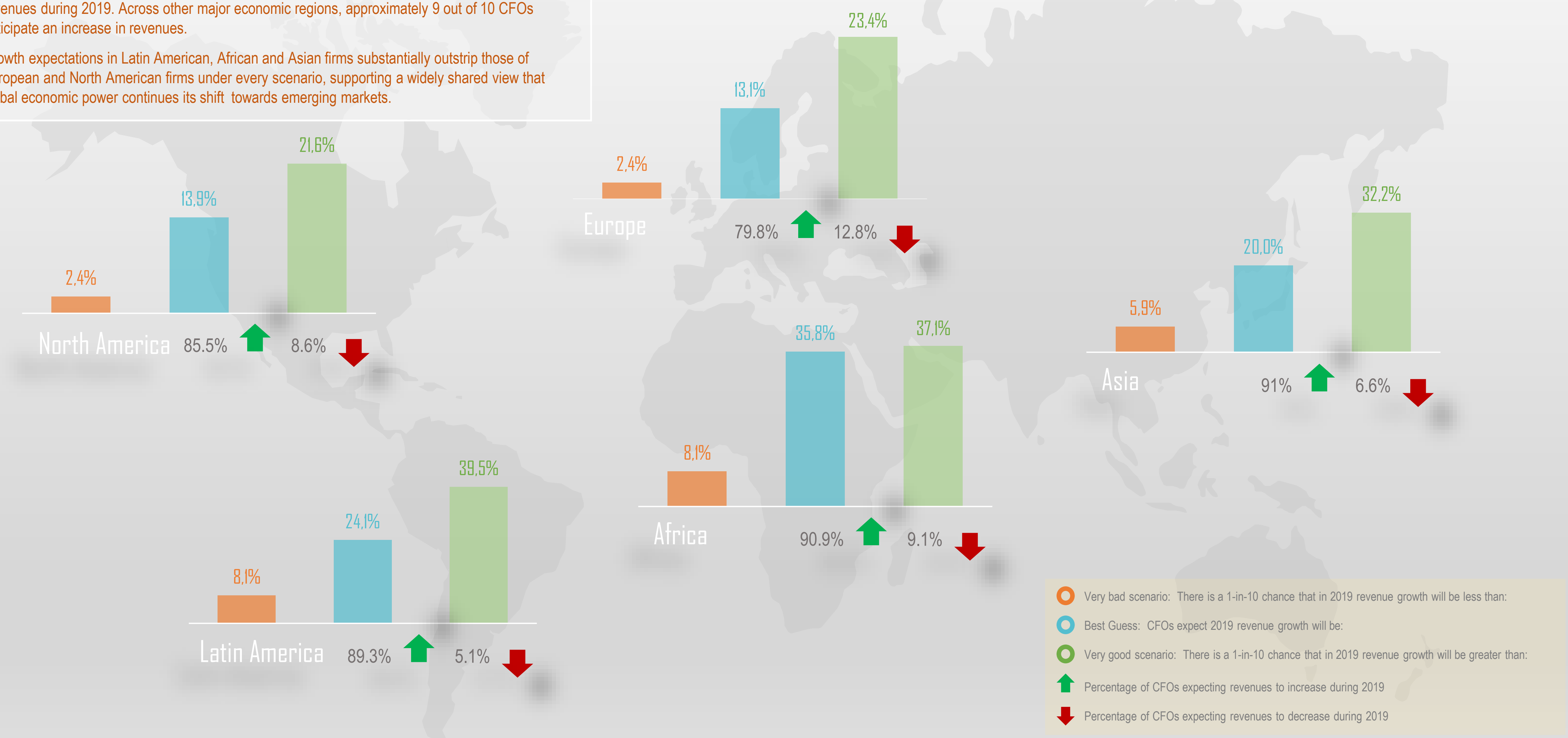
Percentage of optimists -/- percentage of pessimists w.r.t. economy



CFOs' outlook on revenue growth in 2019 under different scenario's

More than three quarters of European financial executives expect to see an increase in company revenues during 2019. Across other major economic regions, approximately 9 out of 10 CFOs anticipate an increase in revenues.

Growth expectations in Latin American, African and Asian firms substantially outstrip those of European and North American firms under every scenario, supporting a widely shared view that global economic power continues its shift towards emerging markets.



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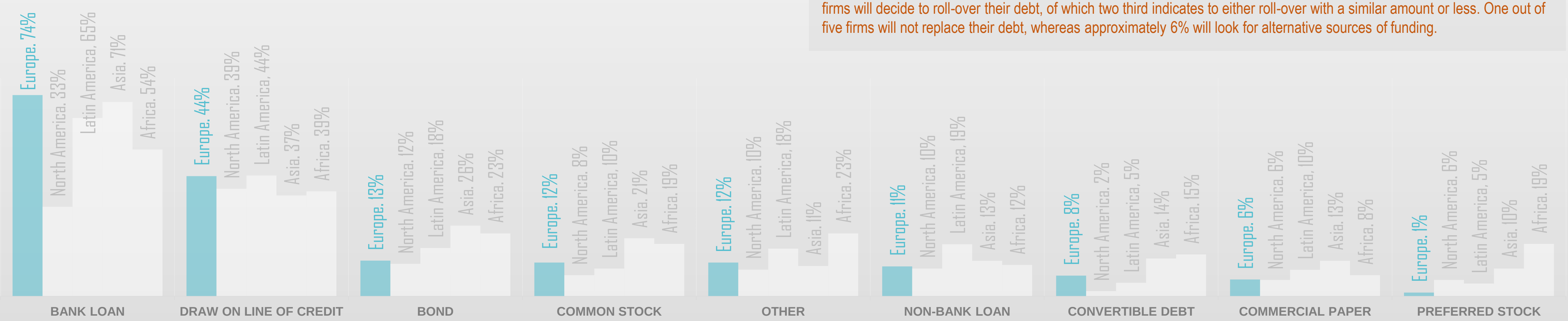
Capital structure

Preferred sources of external funding that firms plan to access during 2019

Percentage of firms planning to acquire specific funding - European firms compared to firms in other major economic regions



Bank loans as preferred source of external funding during 2019

European firms rely mostly on bank loans as primary source of funding. For bank loans that will be obtained during 2019, one third is expected to have a maturity of 4-5 years, whereas another quarter of the bank loans will have maturity of 6-10 years. Only 6% of the loans obtained during 2019 is expected to be short term (<12 months). Almost half of the bank loans obtained till year-end will be fixed-rate loans, whereas a little less than 30% will have floating rates.

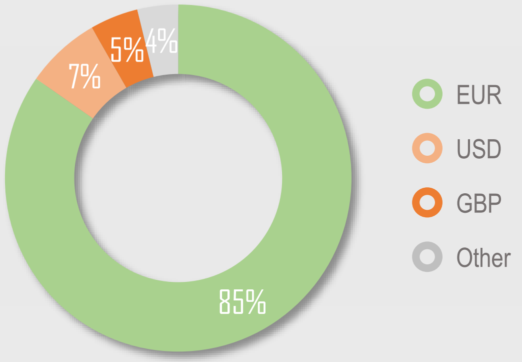
During the next year, 30% of the European firms are expected to retire debt either at or before maturity. In 70% of the cases firms will decide to roll-over their debt, of which two third indicates to either roll-over with a similar amount or less. One out of five firms will not replace their debt, whereas approximately 6% will look for alternative sources of funding.

Primary purpose of borrowing/issuance

Amount of borrowing/issuance (EUR Mln)

	average	median
Common stock:	105	17.5
Preferred stock:	15	1
Bonds:	203	102.5
Convertible debt:	3	2.2
Bank loan:	124	5
Non-bank loan:	37	1.8
Draw on line of credit:	28	2
Commercial paper:	54	3
Other:	21	2.3

Primary issuance currency



Top 3 of debt ratios employed by European CFOs in capital structure monitoring

When you consider the optimal amount of debt for your firm or optimal capital structure, what are the primary metrics your company uses?

1

Debt to EBITDA

Roughly 80% of the CFOs rank the debt-to-EBITDA overall as a top 3 metric for monitoring the optimal capital structure of their firm. 50% of CFOs consider this metric to be the number one leading indicator.

One third of the firms apply a strict target range for how much debt they can take on relative to EBITDA. Roughly 20% applies a flexible target range, while another quarter of firms do not set a target range at all.

Nearly 30% of the firms who define a target range for the debt-to-EBITDA ratio, say to have adjusted this target range at least 3 or more times over the past ten years.

2

Debt to Assets

With half of the CFOs viewing the debt-to-assets ratio overall to be a top 3 metric in tracking the firm's capital structure, it is the second most favored debt ratio by firms.

17% of CFOs view debt-to-assets as the leading indicator and another 21% state this ratio to be their number two primary metric to go by.

More than a third of the firms that employ the debt-to-assets ratio, have set a somewhat tight to strict target range. Yet 14% follows as flexible target, whereas in almost half of the cases no target range is set for debt-to-assets.

57% of the firms have not made any significant adjustments to the target range for how much debt to use.

3

Debt to Equity

Overall, the debt-to-equity ratio is ranked third as primary metric for optimizing capital structure. One tenth of the CFOs view debt-to-equity as the most important indicator whereas the debt ratio is considered as second and third most important by another 15% and 4% of CFOs respectively.

31% of the firms apply a strict target range to their debt-to-equity ratio and another 31% a somewhat tight target range. Slightly less than a fifth of the CFOs who utilize the debt-to-equity ratio say to maintain a flexible target.

Over the last ten years a quarter of the firms have had to adjust their debt-to-equity target only once. Yet a third of the firms have had to make significant changes in their targets more than two times during the past ten years.

Determining the optimal amount of debt to use

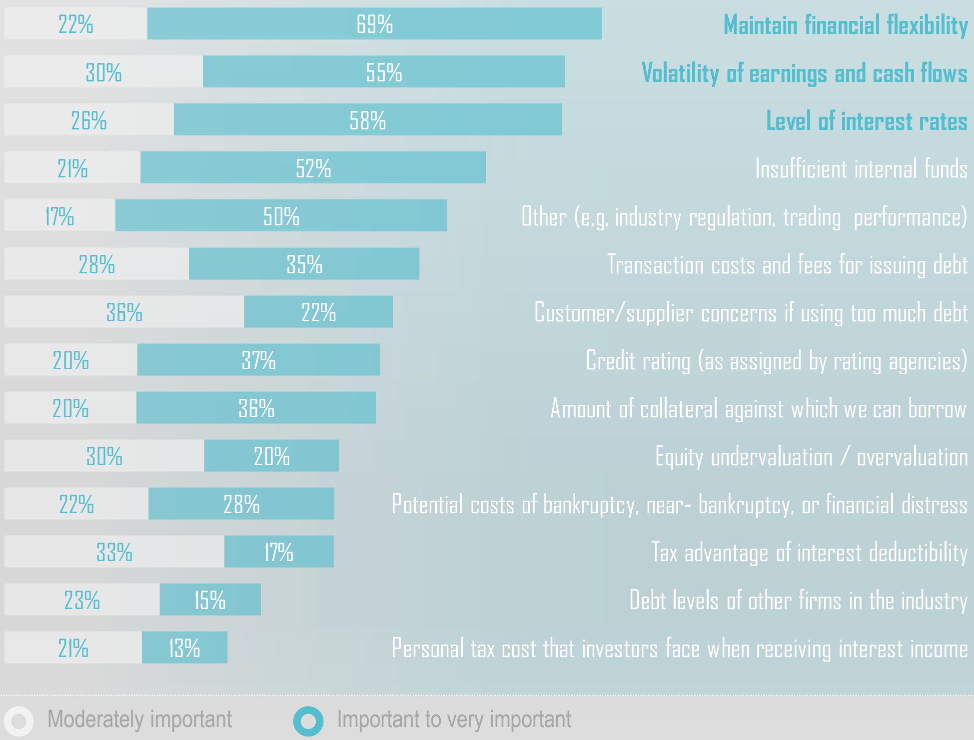
In determining and monitoring the optimal capital structure and amount of debt to take on, CFOs have a set of debt ratios at their disposal for which they specify target ranges. These include: Debt/EBITDA; Debt/Assets; Debt/Equity; Interest Coverage; Credit Rating; Total Liabilities/ Total Assets; and Debt/Value.

Over the last ten years, approximately half of the European firms have adjusted their target debt ratio at least once and up to three times. Almost 15% of the firms have changed the target range for the amount of debt they use more than 4 times.

Large (sometimes unforeseen) capital expenditures and M&A activity (including strategic acquisitions and LBOs) remain the most cited reasons, while regulatory guidelines (e.g. Solvency II requirements) have also been stated as primary drivers to adjust debt levels in recent years.

Choosing the appropriate amount of debt

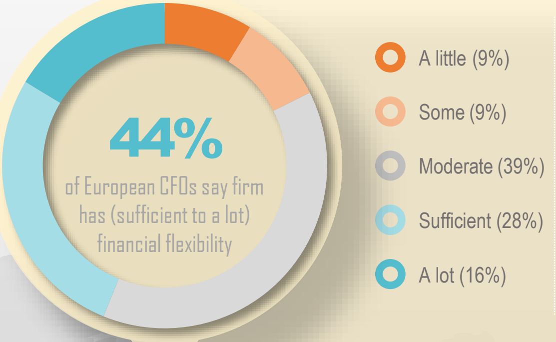
How important are the following factors in choosing the appropriate amount of debt for your firm?



Financial flexibility and liquidity

Compared to other major economic regions, the European cost of (long-term) debt is anticipated to remain relatively low throughout the rest of 2019. Against the background of the higher interest rates as found in the other major economic regions, firms in Latin American, Asian and African territories tend to maintain relatively larger cash reserves.

Yet, a considerable portion of European CFOs state access to the capital markets (i.e. long term debt, short term funding, and equity) as an important reason why they would like to maintain financial flexibility. This may signal that European firms still experience insufficient access to adequate funding sources.



European CFOs state most important aspects of maintaining financial flexibility

63%	Ability to avoid financial distress during economic downturns
56%	Ability to quickly pursue attractive investment opportunities
47%	Preserve unused line of credit capacity
35%	Maintain large cash balance
33%	Access to long-term debt markets
17%	Access to short-term funding (e.g. commercial paper, short-term debt)
9%	Access to equity market

North America

	average	median
Current: Cash-to-Total Assets ratio:	17,04%	10%
Current: Long-term borrowing interest rate:	4,84%	4,45%
Year-end forecast: Long term borrowing interest rate:	5,19%	5%

Europe

	average	median
Current: Cash-to-Total Assets ratio:	13,69%	10%
Current: Long-term borrowing interest rate:	2,83%	2%
Year-end forecast: Long term borrowing interest rate:	2,63%	2%

Asia

	average	median
Current: Cash-to-Total Assets ratio:	20,55%	15%
Current: Long-term borrowing interest rate:	6,03%	6%
Year-end forecast: Long term borrowing interest rate:	6,35%	6%

Africa

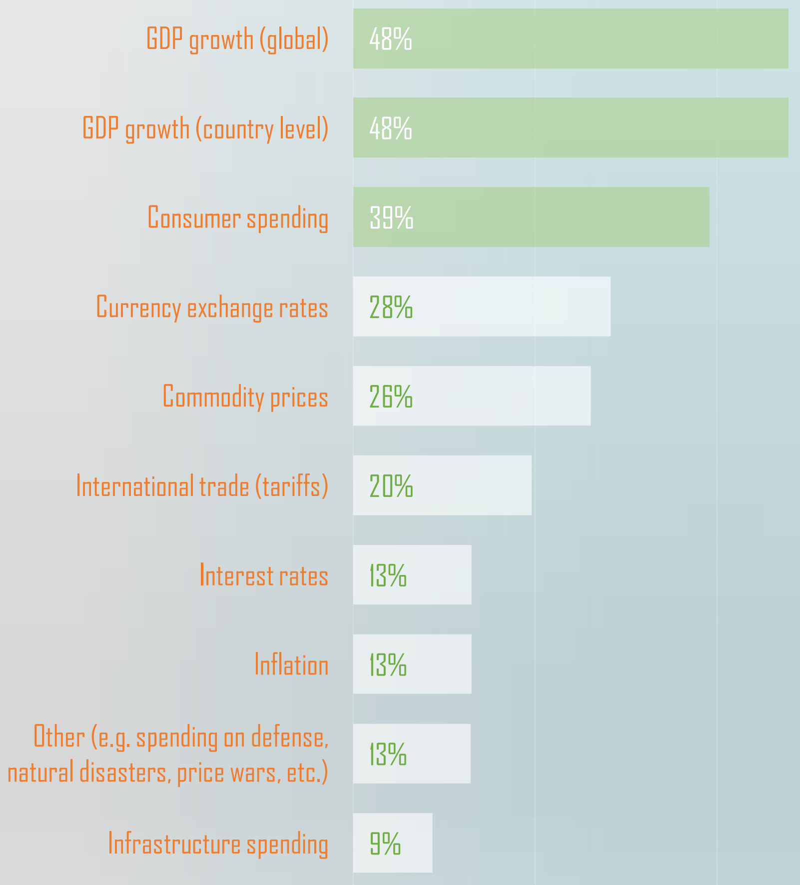
	average	median
Current: Cash-to-Total Assets ratio:	32,88%	20,50%
Current: Long-term borrowing interest rate:	12,02%	10,25%
Year-end forecast: Long term borrowing interest rate:	12,30%	10,88%

Latin America

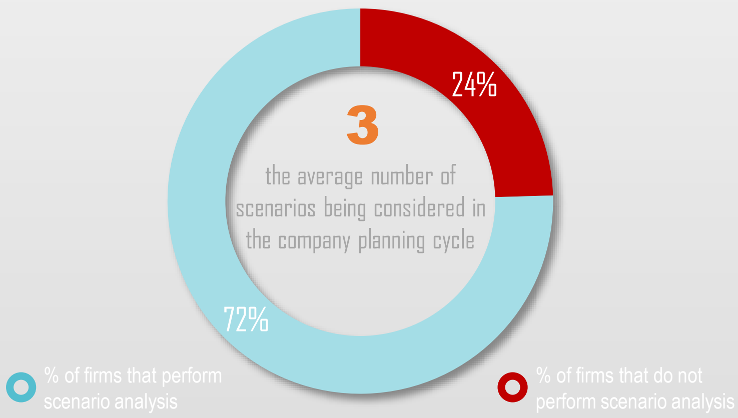
	average	median
Current: Cash-to-Total Assets ratio:	18,38%	10%
Current: Long-term borrowing interest rate:	7,99%	7,45%
Year-end forecast: Long term borrowing interest rate:	7,58%	7%

Corporate financial planning

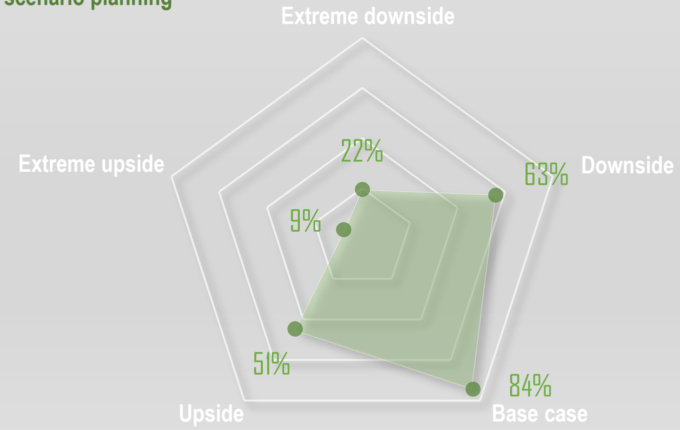
Top 3 economic indicators that CFOs consider most important in causing a firm's downside, base case, or upside outcome



Performing scenario analysis when making plans for the overall company (e,g, 5-year plan)



Scenarios receiving most of the company's attention in scenario planning



Scenario analysis and company planning

7 out of 10 European CFOs perform scenario analysis in the company's planning cycle. This compares to about two thirds of the CFOs in Asian firms who say to conduct scenario analysis, 72% of CFOs in African and in North American companies, and 82% of financial executives in companies across the Latin American territory.

Most European CFOs indicate that GDP growth (both global and at country level) and consumer spending are the most significant (top 3) factors that determine their firm's outcome under downside, base case and upside scenarios. In contrast, CFOs in the other major economic regions (i.e. Latin America, Asia and Africa) attach more importance to economic factors such as inflation, commodity prices, and currency exchange rates.

Should an (extreme) downside scenario become reality during 2019, European CFOs expect a substantial squeeze in the firm's profit margins (lowering to 3% in a downside scenario, to -4% in an extreme downside environment). Capital spending is anticipated to drop to an average of 2% under a downside scenario and -1.5% under an extreme downside scenario).

In order to mitigate a worst case scenario, companies have already taken precautionary steps, ranging from increased flexibility in labor force, tightened monitoring of process and capacity, and asset sales in order to reduce risk, etc. If necessary, firms indicate to be able to reduce CAPEX and operating expenses, including the downsizing of staff, pay reductions, and cutting marketing budgets.

However, according to the European CFOs an (extreme) upside scenario during 2019 could potentially translate into increased profit margins between 7% and 15% on average, coupled with growth in capital spending of between 20% to 43% on average.

Company growth

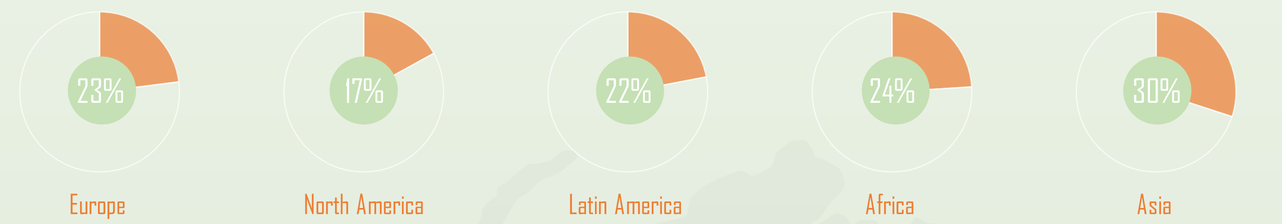
Half or even more of the of CFOs in Europe and across other major economic regions expect the own company to outpace growth of industry peers over the next 3 years.

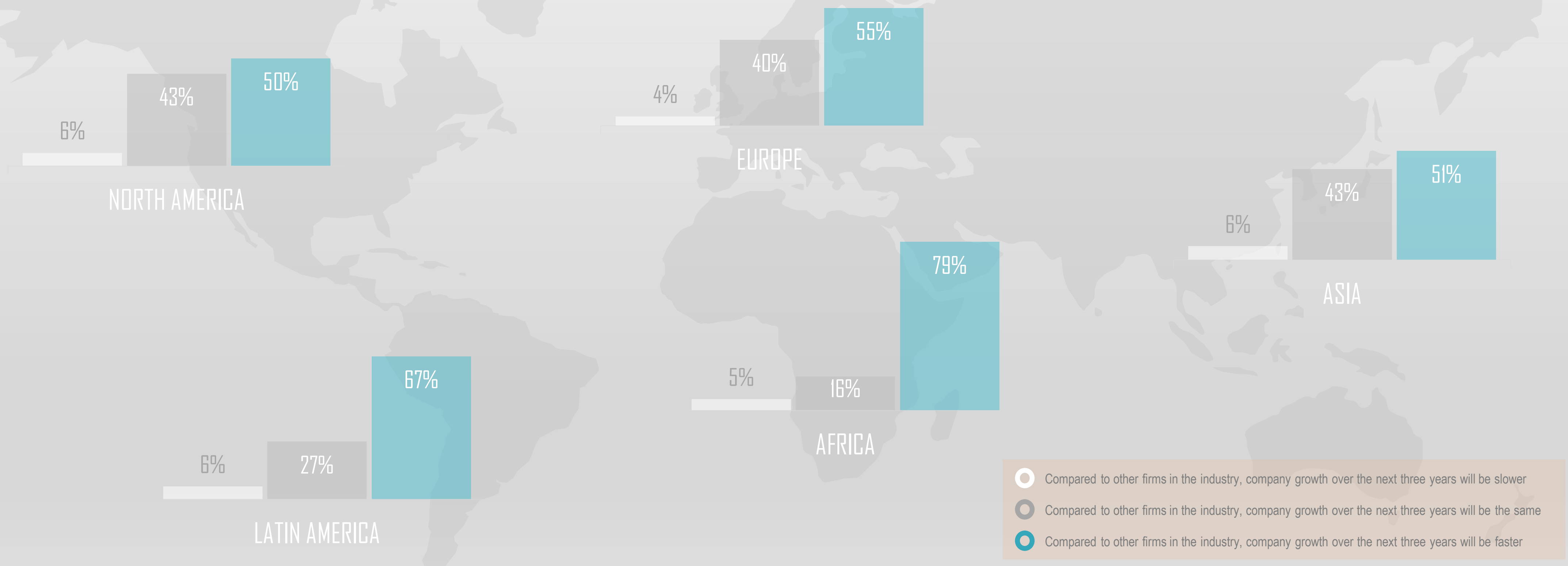
Over the last 4 years, new product development has significantly translated into new sources of income. On average, a quarter of the sales revenues that is generated by European firms today, comes from those new products.

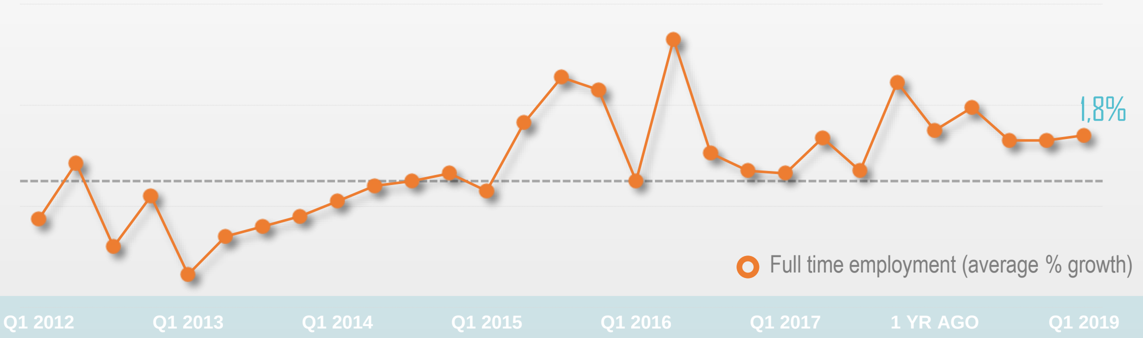
The diversification in revenues is also reflected by the number of market verticals that companies typically accommodate to. Similar to firms in Latin American, North American and Asian territories, companies in Europe cater to approximately 2 to 3 distinct operating segments (e.g. autos, electronics, food, etc.). Firms in Africa operate in 3 to 4 different segments, on average.

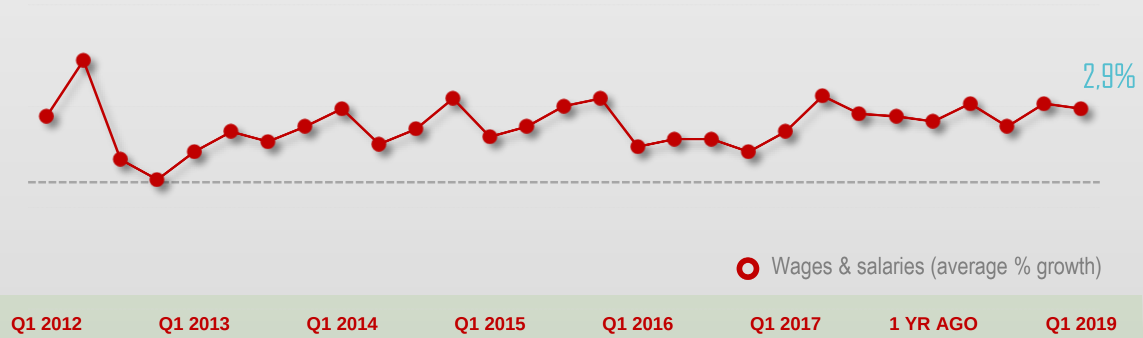
New product development

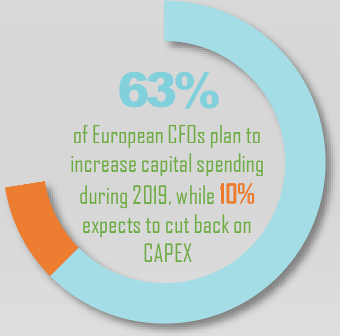
% of current sales revenue coming from new products (that did not exist 4 years ago)











Capital spending by European firms

Expected investment and R&D spending by European firms over the next 12 months

Capital investment	Average total planned spending across all CAPEX projects: **EUR 538 mln**	Average project life of a firm's largest CAPEX project: **6.5 years**	Estimated (average) after-tax ROIC of a firm's largest capital investment project: **18.3%**
R&D spending	Average total planned spending across all R&D projects: **EUR 15.1 mln**	Average project life of a firm's largest R&D project: **3.3 years**	Estimated (average) after-tax ROIC of a firm's largest R&D project: **18.3%**

Hiring, corporate spending & investment

Compared to other major economic regions (which have average expected growth rates for hiring ranging between 3% and 5.5%), European hiring remains moderate and subdued during 2019.

With 8 out of 10 CFOs signaling that firms are planning to increase salaries at an average growth rate of 2.9%, European companies stay far behind the other major economies. In the US and Latin America, growth in wages and salaries is projected at 5% to 5.5% during the next twelve months, whereas in the African and Asian territories, growth in salaries is expected to reach 6%.

63% of the European companies plans to increase CAPEX. In total, the average spending on the largest CAPEX projects across all European firms is projected at EUR 500 mln, and EUR 15 mln for R&D projects. However, with a median of EUR 5 mln (CAPEX) and EUR 700K (R&D) respectively, we should expect to see the majority of spending taking place on projects in single digits during in 2019.

CFOs' top five reasons for setting their hurdle rates higher than WACC is 1) warranting that only the best available projects are chosen, 2) that only profitable projects are chosen, 3) to account for the riskiness of the projects being evaluated, 4) ensuring that projects pay back the initial investment quickly, and 5) to limit the number of approved projects because of funding constraints.

Roughly 18% of the European CFOs has changed the hurdle rate at least 3 or more times over the past 10 years. Almost two thirds of the CFOs state that a change in borrowing cost and/or cost of equity has forced them to adjust the hurdle rate. 4 out of 10 CFOs mention a change in market risk premium as the main reason for the most recent adjustment. About 23% says a change in type and/or location of investments has justified the recalibration of the hurdle rate.

With an average of approximately 7patent filings per company expected for 2019, European firms rank second globally, behind their Asian peers (with 12 patents), and ahead of Latin American (2), North American (3) and African (6) companies.

Weighted Average Cost of Capital (WACC)

average	median
12.41%	9%

Hurdle rate:

average	median
13.75%	10%

Key results CFO Survey

Europe, US, Latin America, Africa and Asia

	EUROPE	UNITED STATES	LATIN AMERICA	AFRICA	ASIA
Economic sentiment					
CFOs More optimistic	26.2%	24.1%	65.8%	50.0%	47.4%
CFOs Less optimistic	38.3%	36.8%	13.1%	35.7%	29.6%
No change	35.5%	39.1%	21.0%	14.3%	23.0%
Own country optimism level	59.5	64.6	65.4	54.8	64.9
Employment – full-time	1.8%	4.6%	5.4%	4.9%	3.0%
Inflation (own-firm products)	n/a	n/a	n/a	n/a	n/a
Financial outlook own company					
CFOs More optimistic	42.4%	48.3%	68.4%	66.7%	60.7%
CFOs Less optimistic	25.1%	36.8%	23.9%	31.0%	19.3%
No change	32.5%	39.1%	17.8%	2.4%	20.0%
Own company optimism level	67.5	70.4	70.8	63.8	69.6
Revenue growth	3.5%	6.3%	12.5%	9.8%	10.4%
Earnings growth	n/a	n/a	n/a	n/a	n/a
Business spending					
Capital spending	8.5%	8.2%	10.0%	16.4%	11.0%
Technology spending	n/a	n/a	n/a	n/a	n/a
R&D spending	n/a	n/a	n/a	n/a	n/a
Advertising and marketing spending	n/a	n/a	n/a	n/a	n/a
Wages and Salaries	2.9%	5.1%	5.5%	5.7%	6.1%
Health Care Costs	n/a	n/a	n/a	n/a	n/a

NOTE: this special edition survey has not covered all of the standard survey questions that one can find in the traditional CFO Survey Europe. Key results indicated by n/a were omitted from the special edition survey.

About CFO Survey Europe
The Special Survey Edition & Note on Methodology

CFO Survey Europe

The CFO Survey Europe is conducted every quarter jointly by TIAS School for Business and Society (Tilburg, Netherlands), Duke University (Durham, North Carolina), and Grenoble École de Management. Previous editions of the CFO Survey Europe can be found at FinanceLab under the CFO Survey tab.

This Special Survey Edition

The Special Survey Edition of CFO Survey Europe aims at documenting best practices in corporate financial planning and capital allocation in European firms and around the globe. The goal of the project is to understand how companies make financial planning decisions dynamically; that is, how companies adapt and adjust to economic conditions that are constantly changing. Hence, the survey questions in this Special Edition will be repeated again in another Special Edition a year from now (Q1 2020).

TIAS

Netherlands-based TIAS School for Business and Society is the business school of Tilburg University and Eindhoven University of Technology. At TIAS we believe that business and society are interdependent and that today's insights are not tomorrow's solutions. Our mission is to have a positive and lasting impact on organizations, business and society by developing critical and inquisitive managers who are able to demonstrate responsible leadership and exceptional decision-making abilities. For more information, visit **www.tias.edu**.

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North Carolina, US-based Duke's Fuqua School of Business was founded in 1970. Fuqua's mission is to educate business leaders worldwide and to promote the advancement of business management through research. For more information, visit **www.fuqua.duke.edu.**

GRENOBLE ECOLE DE MANAGEMENT

Founded in 1984, Grenoble École de Management (GEM) offers executive education on its campuses in Grenoble and Paris. GEM's mission is to accompany corporate performance by providing the knowledge, skills and talent to meet the economic challenges of today and tomorrow. GEM seeks to promote expertise in management of technology and innovation, entrepreneurship and responsible business practices. For more information, visit **www.grenoble-em.com**.

Note on methodology

The figures quoted in this report are taken from the Global CFO Survey for the first quarter of 2019. The survey concluded March 7, 2019. Every quarter, CFOs in Europe, the US, Latin America, Asia (and China), and Africa are polled about their economic expectations. Current quarterly records go back more than 21 years. The survey generated responses from nearly 1,500 CFOs, including 469 from North America, 145 from Asia, 261 from Europe, 590 from Latin America and 42 from Africa.

The CFO Global Business Outlook survey and CFO Survey Europe cover a wide range of companies (public and private, small and large, many industries, etc.). The responses are representative of the population of CFOs that are surveyed. Among the industries represented in the survey are retail/wholesale, mining/construction, manufacturing, transportation/energy, communications/media, technology, service/consulting and banking/finance/insurance.

The average growth rates reported are weighted by revenues or number of employees. For example, one EUR 5 billion company affects on average as much as 10 EUR 500-million firms would. Revenue-weighted mean growth rates are provided for earnings, revenues, capital spending, technology spending and prices of products. Employee-weighted mean growth rates are used for health care costs, productivity, number of employees and outsourced employment. The earnings, dividends, share repurchases and cash on balance sheet are for public companies only. Unless noted, all other numbers are for all companies, including private companies.

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