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CFO SURVEY: OPTIMISM UP, EARNINGS TO RISE

Depreciated Dollar Helping Revenues

Spending and Hiring Still on Hold

Companies Weighing Fatter Dividend Payouts

DURHAM, N.C. and FLORHAM PARK, N.J., June 24, 2003 — Chief Financial Officers of U.S. companies have a renewed optimism about the U.S. economy and predict an increase in their companies' revenues and earnings.

According to the June "CFO Outlook Survey," conducted by Financial Executives International (FEI) and Duke University's Fuqua School of Business, more CFOs are optimistic about the economy than they have been for over a year (see attached chart). Nearly seven out of ten CFOs are more optimistic this quarter (last quarter 25%), and only 7% are less optimistic, compared to almost half (45%) that were less optimistic about the economy last quarter. CFO optimism is also up for their own companies. This quarter half are more optimistic about their companies' financial prospects, compared to 37% last quarter.

The surveyed CFOs say that corporate earnings will increase on average 13.5% (median, 10%) over the next 12 months. Sales revenues are expected to increase for 79% of firms, with an average increase in revenues of 6.3% (median increase of 5%). Both revenue and earnings expectations are up relative to last quarter.

The CFOs say their favorable outlook is driven in part by the value of the U.S. dollar. One in five companies states that sales (number of units sold) will be higher in the second half of 2003 due to the dollar's depreciation.

The CFO optimism about the overall economy also shows up in higher expectations about Gross Domestic Product. Last quarter, CFOs expected GDP to increase by 1.7%, while this quarter GDP is expected to grow by 2.2% over the coming year (median expected increase of 2%).

Spending and Employment

Despite their optimism, CFOs report that capital spending will increase by only 1.5% during the next 12 months. Further, two-thirds of companies say that they are spending at depressed levels, if at all (55% are spending cautiously and 13% are holding off altogether). One-fourth of companies (26%) are spending at a normal level, and only 6% are spending aggressively.

Among those that are spending cautiously or holding off altogether, only 8% say that capital expenditures will return to normal during the next six months and 25% say during the first half of 2004.

Technology spending will remain slow for the next twelve months, with an average increase of only 2.1%. Advertising spending will be flat.

Employment plans are also virtually flat. 43% of companies expect to increase their number of employees, in contrast to 32% that will reduce employment. On average, employment is expected to decline by 0.4% (median: no change).

The U.S. dollar depreciation is having a less positive impact on capital spending and hiring than it is on sales. While 20% of the surveyed CFOs that say the depreciated dollar is increasing sales, only 3% say it will increase capital spending and only the same number say it will increase hiring. Among firms with foreign sales that make up at least one-fourth of their total sales, 51% say that the depreciated dollar will lead to increased sales; however, even among these firms, only one-in-ten says that the depreciated dollar will lead to increased capital spending or hiring.

“While the depreciated dollar will help sales revenue and earnings, these gains will unfortunately have little feedback effect on corporate spending and hiring plans,” said Dr. John Graham, finance professor at Fuqua and director of the survey. “Our big concern is deflation because it would significantly hurt the already modest capital spending plans.”

Beware: Deflation

If deflation were to occur to the extent that overall prices decline by 2% per year, 40% of the surveyed companies would decrease capital spending and 46% say that they would delay all spending.

“These views are consistent with the effects of deflation during the Great Depression,” notes Dr. Graham. “If costs are expected to fall, then companies wait rather than spend now, because the cost of spending is expected to be lower in the future. This can in turn have negative effects on the overall economy, wages and hiring. Alan Greenspan has acknowledged the potential dangers of deflation, and we are confident that the Federal Reserve Bank is taking appropriate actions to keep deflation at bay.”

Legislative Changes Have Impact

The recent reduction in capital gains and dividend tax rates to 15% is expected to reduce the cost of equity capital at 22% of the companies surveyed, with 14% saying their cost of equity will drop a little and 8% saying the reduction will be large. Dr. Graham notes that a reduced cost of equity can lead to reduced overall cost of capital and finally to increased investment.

The reduction in dividend tax rates could also lead to increased dividend payments. Among companies in the survey that currently pay dividends, 28% say they probably will increase dividends and 2% say they definitely will. Among survey companies that do not currently pay dividends, 13% say that they probably will initiate dividends in response to reduced dividend taxation, though none say their plans are definite. Dr. Graham says that increased dividend payments could contribute to consumer spending but does not anticipate any significant increase.

Another legislative change will contribute to an increase in capital spending at one-quarter of companies. The new bonus depreciation provision that allows a 50% deduction of the adjusted basis of qualified property placed in service before January 1, 2005 will lead to a small increase in spending at 15% of companies, a moderate increase at 10% of companies, and a large increase at 1%.

About the Survey

The CFO Outlook Survey, conducted by Financial Executives International and Duke University’s Fuqua School of Business, interviewed 404 CFOs of U.S. companies electronically the third week of June. CFOs from both public and private companies and from a broad range of industries, geographic areas and revenues were represented. Among the industries represented are retail/wholesale, mining/construction, manufacturing, transportation/energy, communications/media, technology, and banking/finance/insurance. Revenue-weighted means were provided for earnings, capital spending, technology spending, advertising spending, inventory and prices of products. Employee-weighted means were used for productivity (output per hours worked), wages, number of employees and overtime.

FEI and Fuqua have conducted surveys gauging the country's economic outlook from the perspective of corporate CFOs for the past seven years. Detailed results of this survey as well as other "CFO Outlook" surveys are available at http://www.cfosurvey.org or http://www.duke.edu/~jgraham

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