

Global CFO Survey: Finance executives pessimistic, earnings and capital spending to slow

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SURVEY: CFO OPTIMISM FALLS; CAPITAL SPENDING AND HIRING TO SLOW; MERGERS AND ACQUISITIONS TO STAY HOT

Note to editors: For additional comment, see contact information at the end of this release.

DURHAM, N.C. -- Optimism about the U.S. economy dipped this quarter among chief financial officers. CFOs expect slow growth in earnings, capital spending and hiring, and are very concerned about rising labor costs and weak consumer demand. The executives also expect merger activity to stay strong for the next 12 months, but to eventually slow due to private equity pushing up the prices of acquisition targets.

These are some of the conclusions of the June 2007 Duke University/*CFO* Business Outlook survey, which asked CFOs from a broad range of global public and private companies about their expectations for the economy. The survey, concluded June 1, generated responses from 804 CFOs, including 484 from the U.S., 172 from Asia and 148 from Europe. The survey of European CFOs was conducted jointly with RSM Erasmus University in the Netherlands. Results in this release are for U.S. companies, unless otherwise noted.

#### SUMMARY OF SURVEY FINDINGS:

-- Optimism index neared a five-year low (posted in September 2006). Only 26 percent of CFOs are more optimistic about the U.S. economy than they were last quarter, down from 35 percent in March. Thirty percent are more pessimistic.

-- Capital-spending plans have fallen, and virtually no increase in domestic employment is expected, though outsourced employment should rise 7 percent.

-- High labor costs, weak consumer demand and skilled-labor shortages rank among the top concerns of CFOs.

-- Eighty-seven percent of CFOs expect merger-and-acquisition (M&A) activity to remain strong through 2008. Nearly 60 percent of CFOs say M&A will finally slow when private equity has pushed acquisition prices up too high. One-third say activity will slow in 2008 because the best deals will have been completed.

#### PESSIMISM ABOUT U.S. ECONOMY

The level of optimism about the U.S. economy dropped, with pessimists now outnumbering optimists. The CFO optimism index for the U.S. economy fell into negative territory for the first time this year (see chart at end of release).

"The optimism index has sunk below the water again, to a level that is low by historical standards," said John R. Graham, director of the survey and a finance professor at Duke's Fuqua School of Business. "With pessimists outnumbering optimists, the prospects for the U.S. economy are poor. The CFO optimism index has a good track record of predicting future capital spending, employment and earnings. The main reasons that CFOs cite for their reduced economic optimism are increased fuel inflation and slowing consumer demand, driven in part by a weak housing market."

CFOs' optimism about their own companies also fell from March. This quarter, 44 percent of CFOs report they are more optimistic about their own company's financial outlook (down from 49% in March). One in four CFOs is more pessimistic about his/her own firm.

#### LABOR COSTS AND WEAK CONSUMER DEMAND TOP CORPORATE CONCERNS

CFOs are concerned about the effects a slowing economy will have on their companies. Wage inflation is the biggest concern among U.S. businesses. U.S. companies expect wages and salaries to increase on average more than 4 percent over the coming year, continuing an upward trend over the past several surveys. Weak consumer demand, spurred in part by high fuel costs and a weak housing sector, is also a major concern.

CFOs' concern about a skilled labor shortage is growing, particularly in the service/consulting, high-technology, and construction industries. Rising health-care costs also remain a top worry, despite a moderate 7.3 percent expected growth during 2007.

#### MERGER-AND-ACQUISITION ACTIVITY

Corporate M&A activity is expected to remain strong throughout 2007, with 36 percent of firms expecting to increase activity, 56 percent expecting to continue M&A at the same pace as last year and only 7 percent expecting merger activity to wane. M&A should be particularly hot in the service/consulting, health-care and technology industries.

"M&A activity should continue to flourish in 2007," said Kate O'Sullivan, staff writer at *CFO* magazine. "A full 85 percent of corporations tell us that they expect M&A to remain strong until 2008 or longer, and only weaken when private-equity buyers have pushed up target prices too high and economic growth slows."

#### CAPITAL SPENDING, HIRING, EARNINGS

Reduced optimism is reflected in capital spending and hiring plans. Capital spending is expected to grow by 5.2 percent over the next 12 months, down from 6.7 percent growth predicted in March. The return on corporate investment is expected to deliver a healthy 13.2 percent internal rate of return.

On average, U.S. companies expect little employment growth over the next 12 months, a notable drop-off from the 1.6 percent increase forecast in March. At the same time, outsourced employment is expected to increase by nearly 7 percent.

Earnings growth is expected to remain modest. U.S. firms expect their earnings to grow 8.6 percent over the next 12 months, down from double-digit growth one year ago. The earnings slowdown will be greatest in the transportation and manufacturing sectors.

"The CFOs see a toxic cocktail that includes slashed advertising spending, a sharp slowdown in tech spending and the most lethargic growth in employment in four years," said Duke professor Campbell R. Harvey, founding director of the survey.

#### INFLATION AND PRODUCTIVITY

Inflation is expected to increase over the next 12 months. CFOs say they expect to increase the prices of their own products by 2.3 percent in the next year, up from 1.8 percent in March. Productivity (output per hour of labor) is expected to increase 3.6 percent in the coming year.

#### RESULTS UNIQUE TO EUROPE

The outlook in Europe is more optimistic than that in the U.S., though less so than last quarter. Forty-one percent of European CFOs have grown more optimistic about the economies of their own countries relative to last quarter, down from the 48 percent reported in March.

European firms expect to increase capital spending by only 4 percent and domestic workforces are expected to contract by an alarming 2.4 percent. The cost of labor is the No. 1 corporate concern in Europe, with skilled-labor shortage and weak consumer demand nearly tied as the No. 2 concern.

More than 90 percent of European CFOs expect M&A activity to be strong for at least another year. The primary factors that will finally slow M&A are the paucity of good deals, higher interest rates and target prices that are too high due to strong private equity demand.

#### RESULTS UNIQUE TO ASIA

CFO optimism remains strong in Asia, with two-thirds of respondents more optimistic about regional economic growth than they were last quarter. Hiring (8.5 percent) should stay strong during the next 12 months, and capital spending is expected to increase 10.8 percent on average. Very high wage inflation (9.8 percent) is expected.

Nearly 40 percent of CFOs in Asia say that pollution in China creates unsafe work conditions for their employees. Among firms with operations or supply chains in China, more than half say there are unsafe working conditions in China, 40 percent say that dealing with Chinese pollution will impose significant costs on their firms and another 40 percent say that employee health-care costs are much higher due to Chinese pollution.

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For additional comment, contact Duke's John Graham at (919) 660-7857 or john.graham@duke.edu or *CFO* magazine's Kate O'Sullivan at (617) 345-9700 (x214) or kateosullivan@cfo.com. For commentary about European results, contact Janet Kersnar at +44 0 20 7576 8100 or janetkersnar@cfoeurope.com or Erasmus's Kees Koedijk at +31 10 40 82748 or ckoedijk@rsm.nl. For commentary about Asian results, contact Don Durfee at +852 2585 3275 or dondurfee@economist.com.

Detailed results, including tabular summaries of the numbers in this release and results from previous surveys, are available at <<http://www.cfosurvey.org>>.

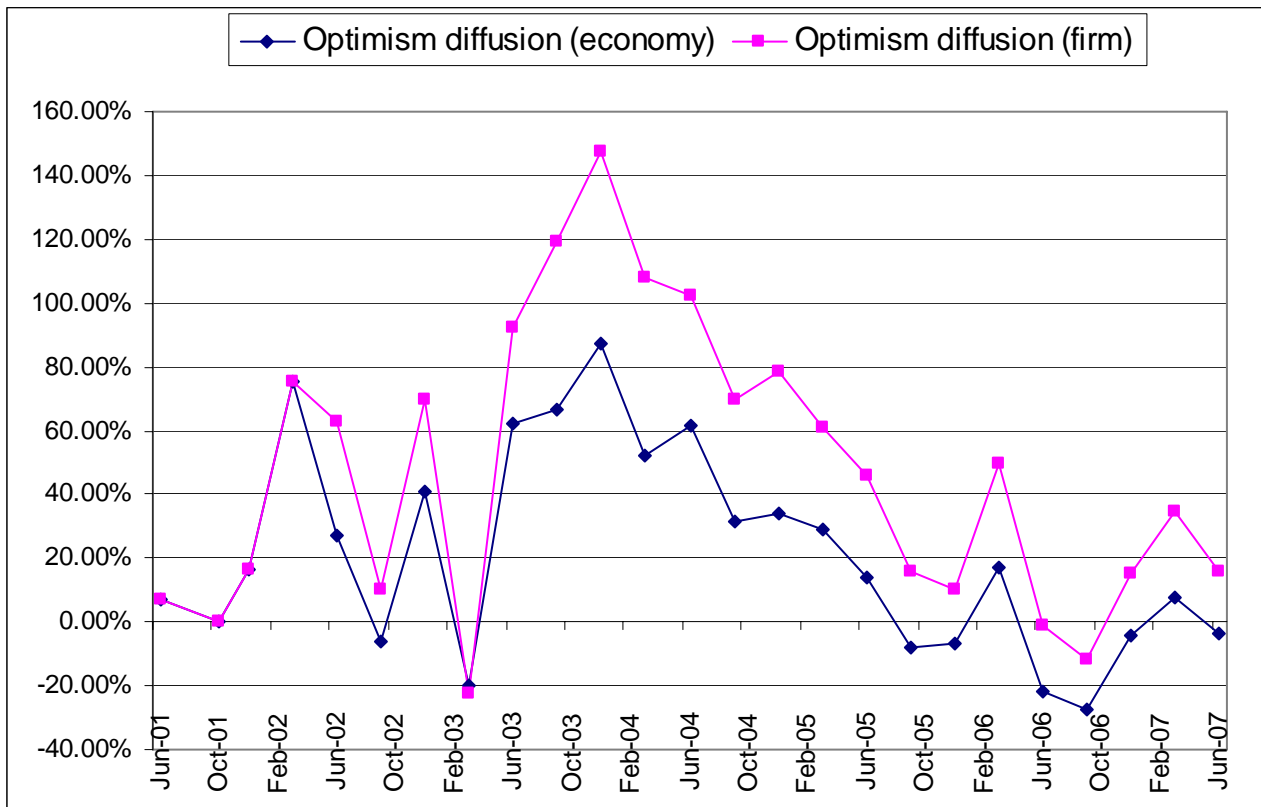
About the survey: This is the 45<sup>th</sup> consecutive quarter that the CFO Business Outlook survey has been conducted. Among the industries represented in the survey are retail/wholesale, mining/construction, manufacturing, transportation/energy, communications/media, technology, service/consulting and banking/finance/insurance. 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 explicitly noted, all other numbers are for all companies, including private companies.

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Optimism diffusion measures the percentage of CFOs who have increased optimism minus the percentage who have decreased optimism.



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