Global CFO Survey: Finance executives more optimistic, but earnings growth to slow

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SURVEY: CFO OUTLOOK IMPROVES; CAPITAL SPENDING, HIRING EXPECTED TO INCREASE, EARNINGS TO SLOW

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

DURHAM, N.C. -- Optimism about the U.S. economy improved this quarter among chief financial officers, but their expectations remain modest by historic standards.

CFOs say they expect to increase capital spending, hiring and merger activity. But earnings growth is expected to slow, and CFOs are concerned about rising labor costs, high health care costs and a shortage of skilled labor.

These are some of the conclusions of the March 2007 Duke University/*CFO* Business Outlook, which asked CFOs from a broad range of global public and private companies about their expectations for the economy. The survey concluded March 2 and generated responses from 741 CFOs, including 454 from the U.S., 169 from Asia and 118 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. firms, unless otherwise noted.

SUMMARY OF SURVEY FINDINGS:

-- Thirty-five percent of CFOs are more optimistic about the U.S. economy than they were last quarter and 27 percent are more pessimistic, which is down from 35 percent last quarter.

-- Capital spending plans have picked up, with an increase of nearly 7 percent planned over the next 12 months, up from 4.9 percent in December.

-- Merger and acquisition activity is expected to continue its brisk pace in 2007. Forty percent say they expect to increase their deal-making activity and only 7 percent say they will engage in less merger activity than last year.

-- Higher wages, weak consumer demand, health costs and skilled labor shortages rank among the top concerns of CFOs. Wage inflation ranked as the top worry for the first time in years.

OPTIMISM ABOUT U.S. ECONOMY

The level of optimism about the U.S. economy continued to recover from a five-year low reached in September 2006. For the first time in more than a year, the CFO optimism index for the U.S.

economy climbed into positive territory, indicating that optimists outnumber pessimists (see chart at end of release).

"The optimism index is still low in comparison to several years ago," said John R. Graham, director of the survey and a finance professor at Duke's Fuqua School of Business. "However, with optimists outnumbering pessimists, the prospects for the U.S. economy are improving. The CFO optimism index has a good track record of predicting future capital spending, employment and earnings."

CFOs' optimism about their own firms has improved even more notably, continuing an upward trend. Nearly half (48.5 percent) of CFOs report they are more optimistic about their own firm's financial outlook, in comparison to only 21.5 percent who say they are less optimistic.

CAPITAL SPENDING, HIRING

The improved optimism is reflected in plans to increase capital spending and hiring. Capital spending is expected to grow by 6.7 percent in 2007, up from a prediction of 4.9 percent in last quarter's survey. Nearly two-thirds of those surveyed say they will increase capital spending during 2007.

More than half (56.5 percent) of companies say they plan to increase the number of domestic employees during 2007, for an average increase of 1.6 percent. Outsourced employment is expected to grow another 4 percent.

Inventories are expected to grow (by 0.5 percent) for the first time in six months, indicating an improvement in the inventory glut that dogged the U.S. economy recently.

MERGER AND ACQUISITION ACTIVITY

Merger and acquisition (M&A) activity has been strong in recent years, with 45 percent of CFOs reporting that their firms made acquisitions during 2006. Corporate M&A activity is expected to remain strong in 2007, with 40 percent of firms expecting to increase activity, 53 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 mining/construction and technology industries.

"M&A activity should continue to flourish in 2007," said Joseph McCafferty, departments editor at *CFO* magazine. "Corporations are telling us that they expect to remain active in the M&A market, on top of the activity being driven by eager private equity buyers."

INFLATION AND PRODUCTIVITY

Inflation is expected to remain moderate in 2007. CFOs say they expect to increase the prices of their own products by only 1.7 percent during 2007, which is within the Fed's target range for inflation. Productivity (output per hour of labor) is expected to increase 3.2 percent in the coming year.

LABOR COSTS TOP CORPORATE CONCERNS; EARNINGS GROWTH TO SLOW

CFOs still have important concerns about running their businesses during 2007. For the first time in several years, rising labor costs is the biggest concern among U.S. companies, with nearly half of CFOs listing wage inflation as one of their top concerns. U.S. companies expect wages and salaries to increase 3.7 percent over the coming year, on average.

CFOs are also concerned about a skilled labor shortage, particularly in the consulting/service, high-technology and construction industries.

The second-biggest worry among CFOs is weak consumer demand. Rising health-care costs also remain a top concern, despite a moderate 6.6 percent expected growth during 2007.

“Earnings are predicted to grow by only 7.4 percent in 2007, which is the lowest growth rate since September 2002,” said Duke professor Campbell R. Harvey, founding director of the survey. “This earnings slowdown is troubling after years of double-digit earnings growth that had preceded the recent slowdown. Given limited ability to increase the prices of their own products, wage and benefit inflation will put increased pressure on corporate earnings during 2007. This, in turn, could harm employment prospects.”

RESULTS UNIQUE TO EUROPE

The European outlook remains buoyant. European firms expect to increase capital spending by 6 percent, and their domestic workforces by nearly 1 percent over the next year, though cost of labor is the No. 1 corporate concern in Europe and skilled labor shortage remains No. 2.

Forty-eight percent of European CFOs are more optimistic about their own countries’ economies relative to last quarter, and 58 percent are more optimistic about the outlook for their own firms.

Germany’s main economic weaknesses are inflexible labor, high wages and high unemployment.

On average, European CFOs do not believe that climate change will adversely affect the financial performance of their own firms: about one-third of European CFOs believe that climate change will have no effect on their firm’s financial performance over the next five years, about one-third say the effect will be negative and one-third say it will be positive.

RESULTS UNIQUE TO ASIA

Capital spending (12.5 percent) and hiring (9.7 percent) should both experience strong growth in 2007. Asian CFO optimism remains very strong, with more than two-thirds optimistic about their national and own-company prospects in 2007.

High wage inflation (8.5 percent) is expected.

A plurality of Asian CFOs expects China and India to experience a recession in three to five years. More than three-fourths of CFOs list inadequate public infrastructure as India’s greatest weakness. The survey showed the top weaknesses in China are an underdeveloped legal system and a shortage of skilled labor.

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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 44th 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 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 and cash on balance sheet weighted numbers are for public firms only. Unless explicitly noted, all other numbers are for all firms, including private.

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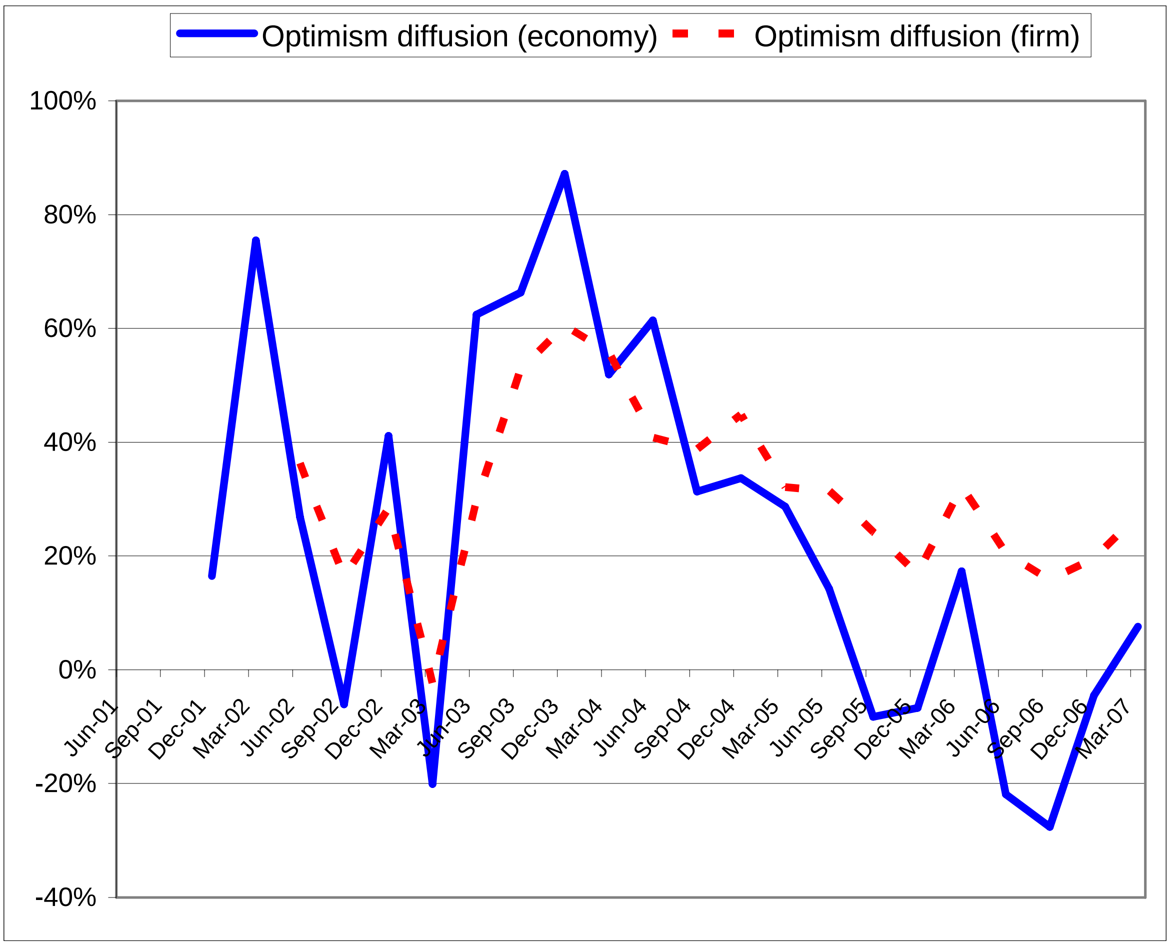
Optimism diffusion measures the percentage of CFOs who have increased optimism minus the percentage who have decreased optimism.



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