2015 CFO Outlook Asia

A Survey of Chief Financial Officers

Bank of America Merrill Lynch

Charting a course to growth

With a high level of confidence, CFOs of Asia's largest companies are planning for growth while navigating financial risks

About the survey

In the first quarter of 2015 The Economist Intelligence Unit surveyed 630 financial executives from companies across a range of industries in 12 countries and territories in Asia (Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan and Thailand). Respondents included chief financial officers (57% of the total), financial directors, senior vice-presidents of finance and treasurers (21%) and those with other senior finance function titles (22%). Half the respondents were from multinational corporations and half from companies with operations in only one country. All multinational companies that participated have global annual revenues of at least US$500m; all local companies have revenues of at least US$100m. The EIU also conducted in-depth interviews with a number of CFOs across Asia. Our thanks are due to all interviewees and survey respondents for their time and insights.

For certain questions respondents could pick more than one answer, meaning responses may not always add up to 100%. All data in figures is from the survey unless otherwise noted.

More information available: **bofaml.com/apac-cfo-outlook**

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Welcome

Opportunity knocks, headwinds remain

For Asia Pacific's most influential CFOs, 2015 will be a year of growth but will require a heightened level of courage, commitment and care to deliver on expectations. Change will be inevitable. Challenges will be multi-faceted. Risk and market volatility will remain a reality. But with an actively managed finance strategy and a clear understanding of the diverse headwinds, opportunities will materialise. These are some of the projections of Asia Pacific's leading CFOs.

In its fourth year, the 2015 CFO Outlook Asia presents the most holistic picture of the operating environment faced by corporations in this region. While positive on revenues, the catalysts of growth will more frequently come from non-traditional sources, according to CFOs of the largest corporations operating in Asia Pacific. Furthermore, market issues such as currency volatility and potential interest rate movements will increasingly influence decisions at the enterprise level.

Hence, the 2015 findings reinforce the ever-changing role of the CFO as an incubator of growth, a manager of diversified risk and an authoritative voice in and influencer of the regional economy—a role where success requires on-the-ground expertise, access to actionable insights and a relationship with a locally-minded, globally-based partner. This is the commitment Bank of America Merrill Lynch delivers to its corporate clients in Asia Pacific and across the globe.

To better understand the views of Asia Pacific's most influential CFOs, including key findings, in-depth analysis, interactive content and insights from industry leaders, I encourage you to visit **bofaml.com/apac-cfo-outlook**

Steven R. Victorin
Head of Asia Pacific Corporate Banking
& Global Corporate Banking Subsidiaries

Bank of America Merrill Lynch

Key findings from the 2015 survey

CFOs across Asia Pacific have spoken and shared their views on the operating environment for their businesses in 2015

Confidence towards regional growth prospects remains high, but CFOs in Asia Pacific are more conscious of the external risks than in previous cycles. Given this backdrop, CFOs will focus on implementing internal best practices to offset external volatility by enhancing working capital and improving operational efficiencies.

Organic growth is strategically crucial, while after a boom in 2014 the outlook for M&A also remains positive. Strong equity markets and cheap debt provide an array of funding choices, but with risks on the horizon CFOs are also taking the chance to build war chests to finance their ambitious growth plans.

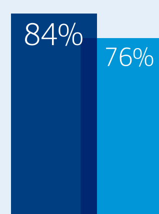
The big picture: Heeding the call to grow

Asia CFOs' confidence is robust: Some 84% of CFOs expect their revenues to grow in 2015, while 73% expect profits to grow. This is up from 2014, when 76% predicted revenue growth in their companies and 60% expected growth in profits. Confidence in generating profit growth is higher in each of the region's major economies, despite prospects for slowing economic growth in the region.

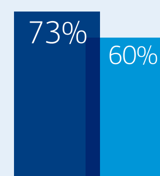
CFOs are focusing on the basics to enhance growth. A strong majority (70%) of CFOs are looking to improve profitability through better management of working capital, substantially more than the 41% who saw this as a focus in 2014 (when use of technology was the prime focus to boost margins). More than half (56%) will be looking to operational efficiencies to improve profitability, up from 45% in 2014. The price of oil is helping: 35% say that lower energy costs have a major positive impact on their business, while 43% see a slight positive impact.

Asian CFOs' confidence is robust...

2015 2014



Substantially more CFOs expect their revenues to grow in 2015 than in 2014...



...and more CFOs expect profits will grow

but financial risk becomes a central concern

2015:
54%

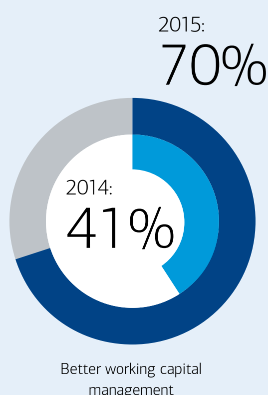
2014:
36%

of CFOs naming financial risk as a single greatest worry

CFOs go back to the basics

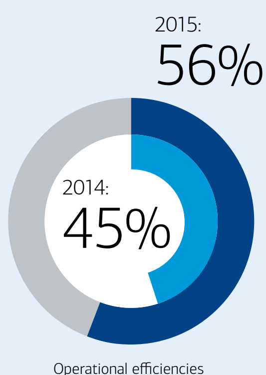
Means to improve profitability:

2015:
70%



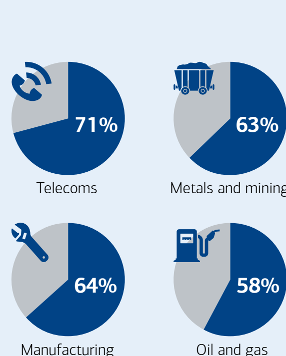
Better working capital management

2015:
56%



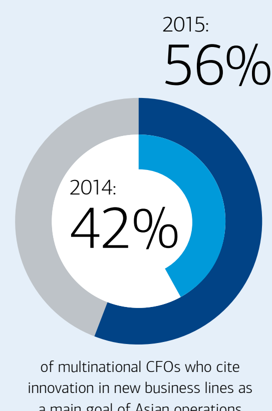
Operational efficiencies

Competitive pressures pushing multinationals to innovate



Top industries looking to innovate in new business lines in Asia

2015:
56%



of multinational CFOs who cite innovation in new business lines as a main goal of Asian operations

Key findings from the 2015 survey

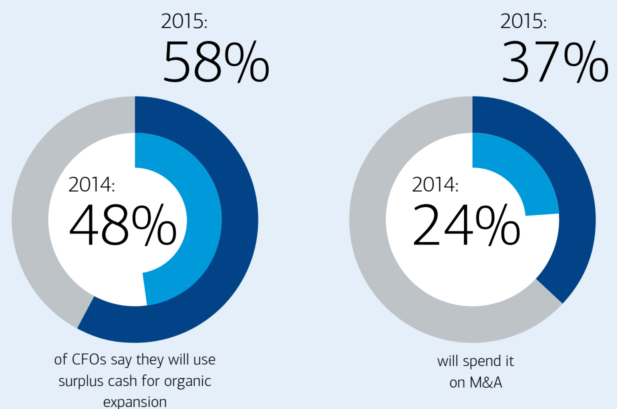
Growth strategy: Expansion on the agenda

Despite tougher conditions, growth is the goal. More CFOs name organic expansion (58%) than acquisitions (37%) when asked how their companies will most likely use surplus cash in 2015. But both figures are substantially up year-on-year—48% for organic growth and 24% for acquisitions, respectively, in 2014—signaling that CFOs see important opportunities to grow by either method in Asia this year.

Competitive pressures mean the focus on innovation is growing. While most CFOs are looking to improve profitability through better management of working capital and operational efficiencies, multinationals in the region are also under pressure to innovate in new business lines in the face of the rise of competitive local companies and fierce battles for market share. Some 56% of CFOs from MNCs say this is a main goal of their Asia operations in 2015, up from 42% in 2014—with telecoms and manufacturing (71% and 64%) the sectors most eager to innovate.

MNCs' investment in China operations is not off the cards, but enthusiasm has dropped. The proportion of Asia CFOs at multinationals who say their companies are thinking about moving some operations from China to elsewhere in Asia has grown to 47% in 2015, from 43% who considered the possibility or did so last year. Meanwhile, 37% are thinking about cutting headcount in China, up from 28% in 2014. Still, 45% say they are considering investing more in operations in China in 2015 (albeit down from 55% in 2014), and other factors suggest a major shift out of Asia's biggest market is unlikely.

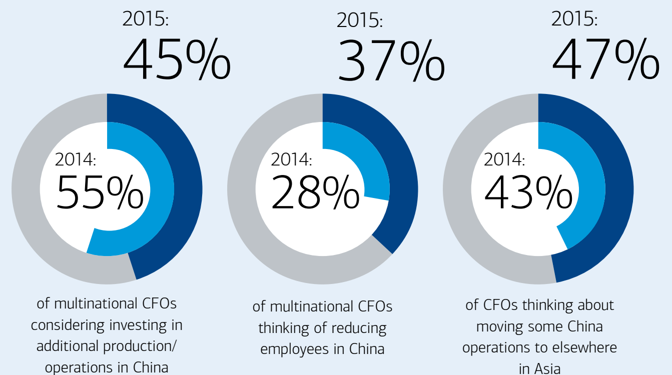
With a bigger appetite for growing organically and also for M&A…



Still investing in China… but the figure is down

While more consider cutting China headcount

And many consider a move



M&A: The boom continues?

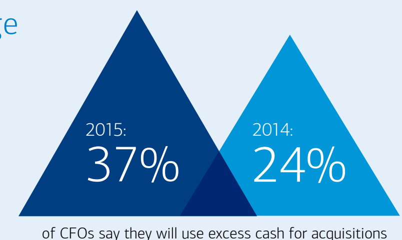
M&A remains hot: After a bumper year in 2014, more CFOs are considering the M&A route to growth. Thirty-seven percent of CFOs responding to this year's survey say they will use excess cash for acquisitions, up from 24% last year. Among Asia's larger markets, there are notable rises in M&A appetite among CFOs based in India (69%, up from 22% last year) and China (49%, up from 24% in 2014).

A shift in acquisition target countries is underway. CFOs name Greater China, Japan, and Australia as the top destinations for M&A in 2015, with South-east Asia—the top-ranked destination last year—in fourth place. At the same time, Western Europe and North America have both increased in attractiveness for Asian acquirors. Competitive pressures as economies slow, weaker currencies (improving asset pricing for external acquirers), and industry consolidation are common themes that will continue to drive M&A after a bumper year in 2014.

China's position in first place should come as no surprise. Last year China saw its highest full-year M&A volume on record despite persistent concerns about macroeconomic trends, and the number and size of deals in China will still dwarf those in other markets, despite the prospect of "only" 7% GDP growth in 2015. Asian buyers (like Japan's Itochu and Thailand's CP Group, which united recently for a US$10.4bn stake in CITIC) are on the lookout, while domestic M&A is also being driven by more aggressive private-sector participation and the easing of lending rules to enable consolidation in industries with excess capacity.

Acquiring intellectual property, technology and talent intensify as drivers for M&A. About half of CFOs in 2015 say that a primary driver for acquisitions will be buying intellectual property or technology (48% in both cases). This is up from a response of 29% for intellectual property and 34% for technology last year. Buying to achieve growth goals (e.g. acquire market share) has become less important, picked by 48% of CFOs, down from 70% in 2014.

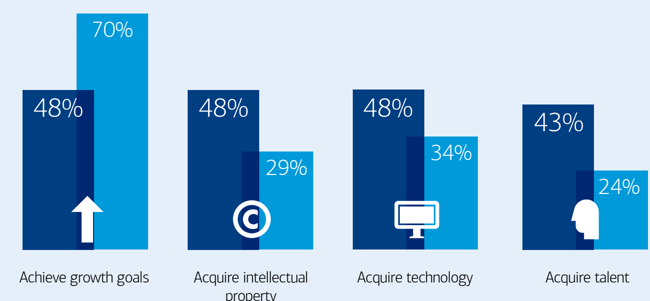
Ongoing M&A surge to be supported by excess cash



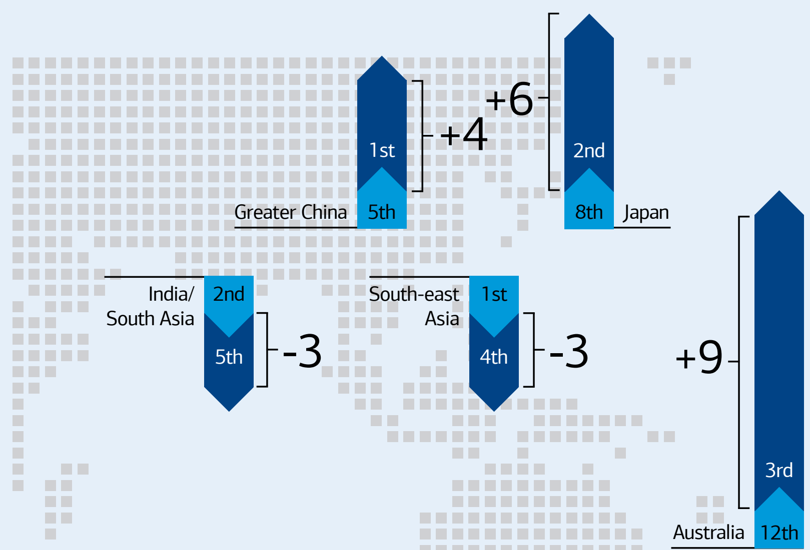
of CFOs say they will use excess cash for acquisitions

Asia CFOs look to acquire the tools to grow

Main motive for acquisitions



Wealthier economies become areas of M&A focus



Note: All figures are percent respondents from 2015 CFO Outlook Asia survey unless otherwise indicated. Figures may not round to 100 either due to rounding or because respondents could select multiple answers.

Key findings from the 2015 survey

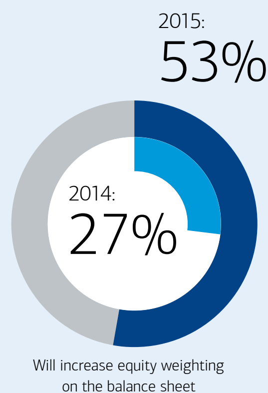
Finance: Striking while the iron is (still) hot

Raising equity is hot again… More than half of Asia's CFOs (53%) say that their companies are likely to increase their equity weighting on their balance sheet, up from 27% last year. It's all in the timing. Issuing shares now as prices are rising in markets across the region allows companies to lower equity-debt ratios ahead of a period when borrowing and servicing debt is expected to become more expensive. Deleveraging is a motive for capital structure change for more than third (41%) of the companies in the survey this year, compared to 15% last year.

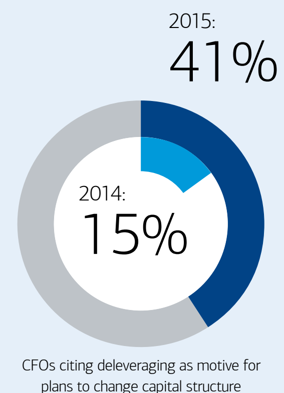
…but borrowing is also attractive—for now. Leverage building among Asian corporates has become an increasing concern for investors, but conditions that favour low-cost borrowing still persist as the rest of the world eases monetary policy while the US is still just thinking about tightening. International and local-currency bonds are higher in the ranks of preferred funding sources this year than in 2014 (though still below equity). And some 62% of CFOs say their borrowing needs will increase in 2015 from the previous year, double the number of respondents who said so in 2014.

Banks remain the preferred source of financing. Bank loans still remain the most preferred avenue of funding for companies in Asia, unchanged from last year. Meanwhile cash flow financing—a practice in which a bank lends funds, generally for working capital, using the expected cash flows that a borrowing company generates as collateral—is on the rise. Forty-six percent of CFOs say they plan to use this type of financing this year, up from 18% last year.

Equity is hot again, as concerns over leverage grow

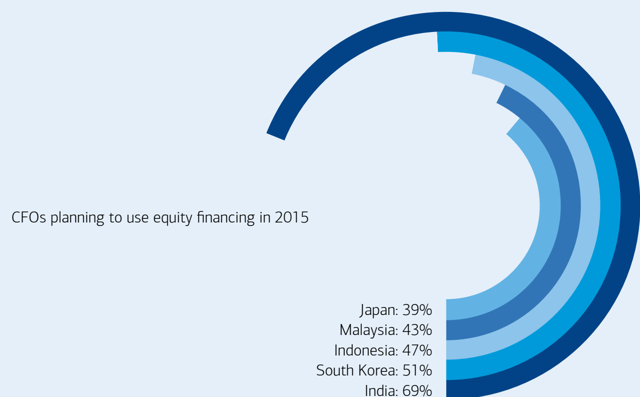


Will increase equity weighting on the balance sheet



CFOs citing deleveraging as motive for plans to change capital structure

Appetite for equity financing strongest in…



Risk: Welcome to a more volatile world

CFOs are wary over the prospects of a US interest rate hike but confident in their ability to manage the risk. Some 86% of CFOS agree or strongly agree that rising interest rates in the US will cause major problems in Asia. Furthermore, 41% name interest rate movements in general as a primary concern, up from just 20% in 2014. However, only 17% of CFOs believe that rising US interest rates will have a negative impact on their own businesses, signaling confidence in funding strategies and hedging programmes.

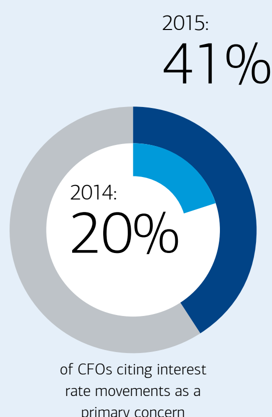
Exposures to adverse shifts in the US dollar have climbed, but CFOs are hedged. CFOs are covering the risk: 44% of the respondents say they have significant exposure to the US dollar, while 42% say they are hedged against adverse movements in the currency, up from 23% last year.

More CFOs are concerned over slowing growth in home markets. Ebbing growth at home is cited by 37% of Asia CFOs as the biggest macroeconomic risk for 2015, up from 23% in 2014. In China the figure is 43%—far higher than the 17% who cited this as an issue in 2014.

Asia's CFOs are building a cash buffer for a rainy day. Almost three quarters (72%) of CFOs say they will deploy surplus cash by building cash reserves, up sharply from 28% last year. This is a familiar risk-mitigation strategy in Asia as volatility increases and interest rates are expected to rise, reflecting companies' institutional memory of the 1997 Asian currency crisis.

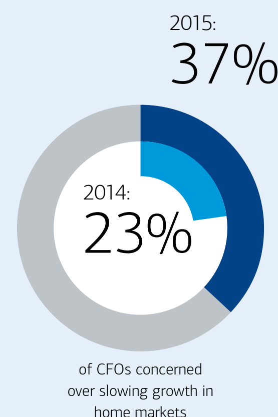
Worries over interest rate movements and slowing growth are mounting

2015:
41%



of CFOs citing interest rate movements as a primary concern

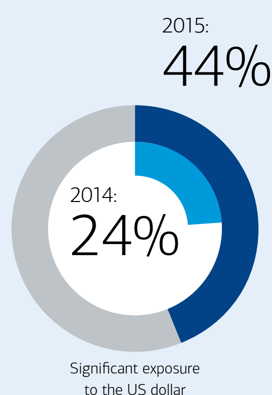
2015:
37%



of CFOs concerned over slowing growth in home markets

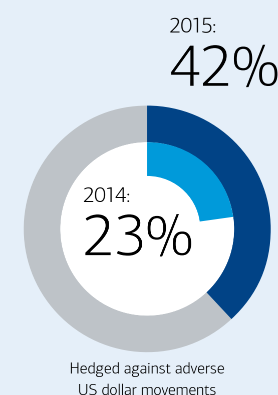
But while exposures to currency volatility are high, CFOs are hedged

2015:
44%



Significant exposure to the US dollar

2015:
42%



Hedged against adverse US dollar movements

I. The big picture: Heeding the call to grow

Asia's CFOs are looking on the bright side and growing value in a more challenging environment through focusing on the basics—while also targeting more acquisitions

Across Asia, it's time to grow. Despite the evident economic headwinds, confidence abounds among CFOs in the region, accompanied by a sense of urgency that 2015 presents a rare opportunity to grow that must be seized.

"What is really important is participating in the growth of ASEAN [and] China—with the technologies, services and products that Japan can provide," notes Tsuyoshi Hachimura, CFO of Itochu. This sentiment of *carpe diem* rings true for all the CFOs interviewed for this report. With financing conditions still favourable and coming off a year of record-breaking M&A activity, CFOs are primed to make the most of Asia's growth story, and are confident that they have the experience and financial tools to do so.

Something is going very right. Business confidence among CFOs has grown since last year—a year in which CFOs in the region were already positive. Some 84% of the CFOs in the survey expect their revenues to grow in 2015, while 73% expect profits to grow. In the 2014 survey 76% predicted revenue growth in their companies, while 60% expected growth in profits. Confidence in generating profits is higher in each of the region's major economies—69% of the CFOs responding in Japan see profit growth, versus 57% in 2014; 81% in China this year, versus 59% last year, 63% in South Korea this year compared to 46% last year, and 85% in India in 2015 compared to 72% in 2014 (Figures 1.1 and 1.2).

Figure 1.1: Surprisingly upbeat?
% respondents expecting growth in revenues; change year-on-year in percentage points

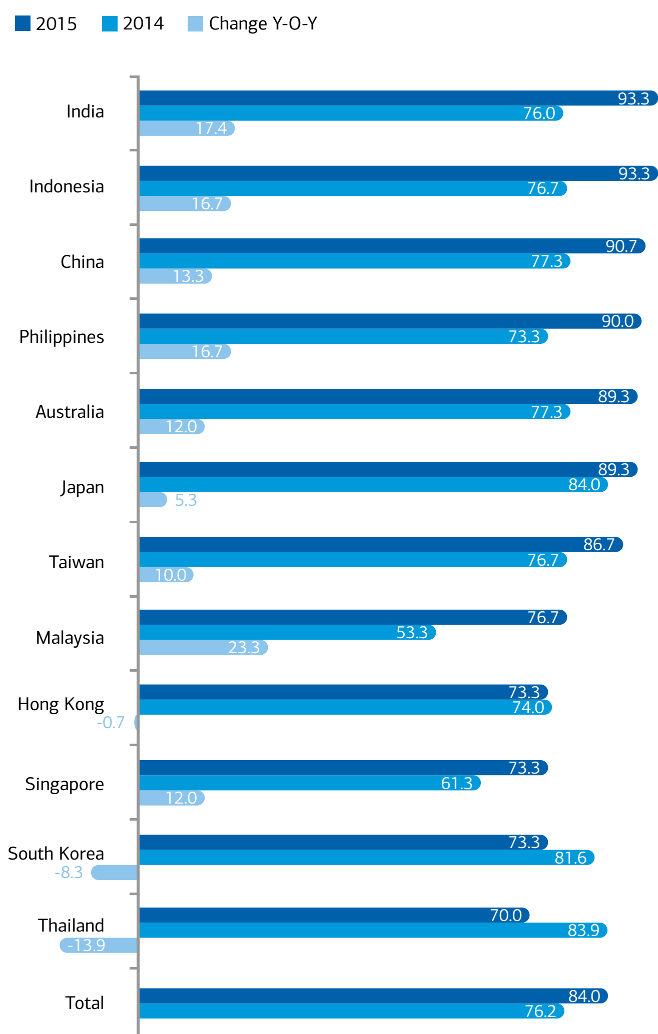
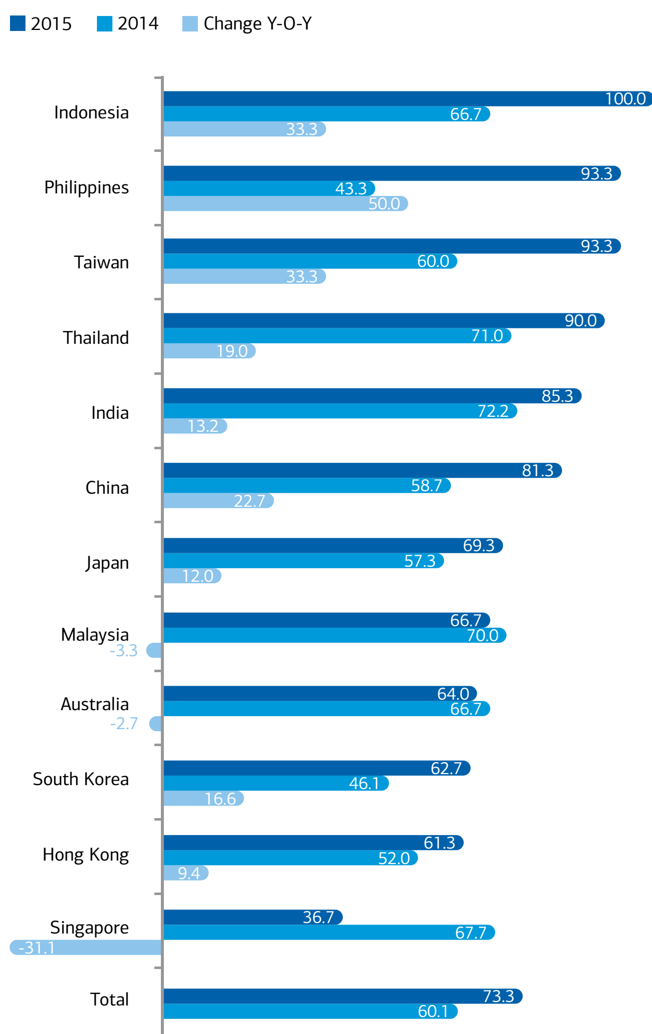


Figure 1.2: Focusing on the bottom line
% respondents expecting growth in profits; change year-on-year in percentage points



Yet the more positive nature of the responses across the board (with only a few exceptions) seems counterintuitive in an environment in which GDP growth is either slowing, flat or growing only incrementally. The Asian Development Bank, for instance, expects total growth for East Asia to be 6.5% in 2015, compared to 6.6% in 2014[1]. This is partly down to China's announcement on March 5th of a 7% growth target for 2015, below the 7.5% target set by the government for 2014 (which China missed, as its economy grew 7.4%). In South-east Asia, the ADB sees growth increasing to 4.9% from 4.4%, a healthy rise—but one that factors in an expected expansion of 3.6% in Thailand, up from 0.7%, which skews the average. (Thailand's slender growth in 2014 resulted from the country's political turmoil, which squeezed commerce and trade.) The EIU, meanwhile, forecasts growth of 4.5% across the whole Asia-Pacific region (including Japan), up marginally from 3.9% in 2014 (Figure 1.3).

Indian in spirit

Perhaps most significantly, India is the new leader of the pack. Growth projections for India—up to 7.3% from 7.0% last year (after a controversial rebalancing of GDP data that boosted growth numbers)—reflect the enduring honeymoon that Narendra Modi and the ruling Bharatiya Janata Party have enjoyed since his election in May 2014. Better expectations among CFOs in India for growth and profits in the 2015 CFO Outlook Asia survey reflect the power of optimism in an economy long bound by concerns over crumbling infrastructure, bureaucratic obstructionism and concern over lack of transparency in government.

Saumen Chakraborty, CFO of Indian pharmaceutical giant Dr Reddy's, sees it as more than a passing phenomenon but as a fundamental change in the psychology of the workplace.

"Not that long ago I used to see Americans in India working late while Indians were restricted to office hours," he recalls. "Over the last few years—in the IT industry, but in ours as well— that's completely changed. People are working very hard. Educated people are trying to hone their skills."

Something of that can-do spirit has rubbed off on all CFOs throughout the region. Expectations for expansion in 2015 have soared, with 58% of CFOs saying they will use surplus cash for organic growth, up from 48% last year (explored in section II). The attraction of investing in growth through M&A (examined in section III.) has increased at an even stronger clip, with 37% saying they will spend their excess cash on M&A, compared to 24% last year.

Either way, the focus is growth. The 2015 results suggest that Asia's CFOs have won a victory—if not the war—in the more mundane arts of the job. In the 2014 survey, CFOs' responses showed an expansion in the margin between the proportion expecting revenue and profit growth to 16 percent points, from seven percentage points in 2013. That margin in 2015 has contracted to 11 percentage points (Figure 1.4).

[1] Asian Development Bank, Asian Development Outlook 2015, March 2015. Available at http://www.adb.org/publications/asian-development-outlook-2015-financing-asias-future-growth. The ADB defines East Asia as China, Hong Kong, South Korea, Mongolia and Taiwan, and South-east Asia as the 10 members of ASEAN.

Figure 1.3: Asia's new growth leader

Real GDP growth in %; change year-on-year in percentage points

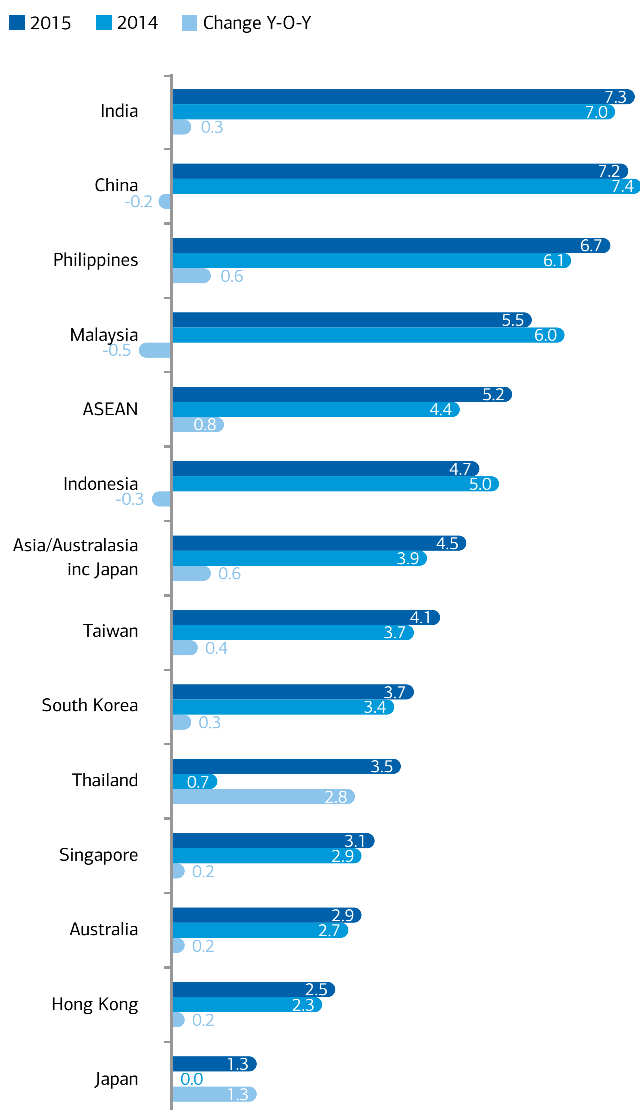
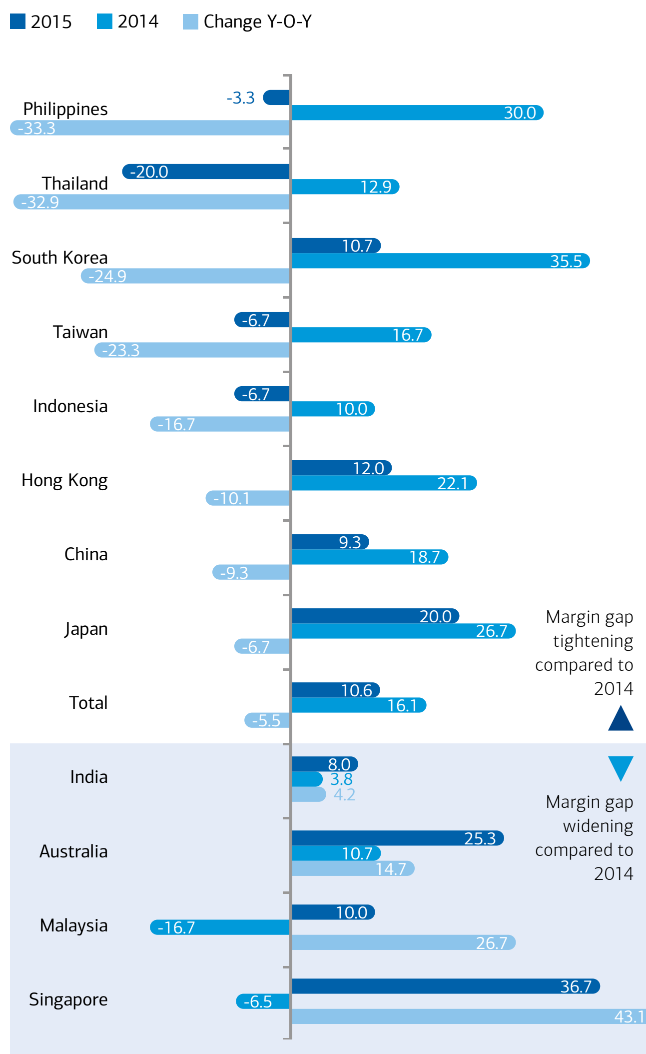


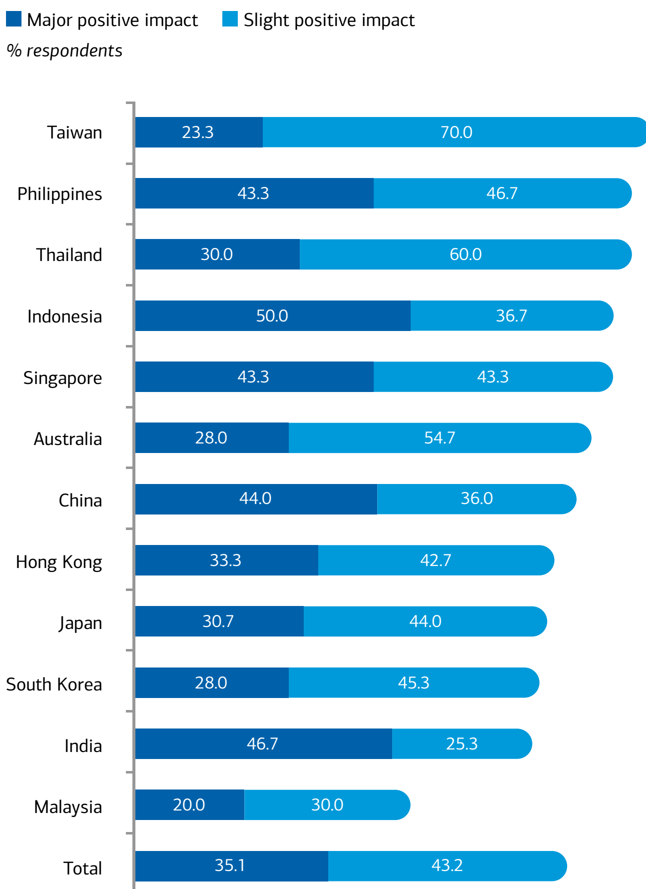
Figure 1.4: Closing the margin gap

Difference between proportion of CFOs expecting revenue and profit growth percentage points



To be sure, that gain also reflects the positive impact of lower energy costs on CFOs' expectations for revenue and profit growth this year; some 35% of Asia's CFOs say that lower energy costs following a decline in the price of crude oil (which halved to around US$50 per barrel in March from US$100 last August) will have a major positive impact on their business, while 43% see a slight positive impact (Figure 1.5).

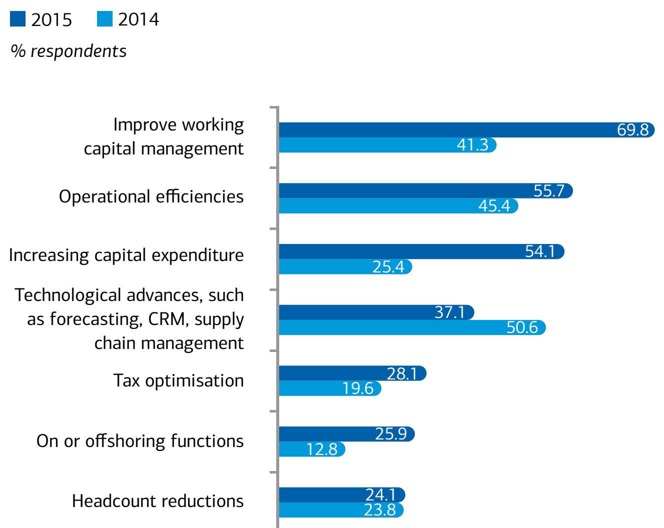
Figure 1.5: Get it while it's cheap
How significant an impact on your business will lower energy costs have in 2015?



Realising gains from cheaper inputs is also a result of better performance in such basic disciplines as optimising management of working capital and taking unnecessary costs out of businesses. This year, Asia's CFOs are intensifying their focus on gains earned this way. A strong majority (70%) of CFOs are looking to better working capital management to improve profitability, substantially more than the 41% who saw this as a focus in 2014. More than half (56%) will be turning to operational efficiencies to boost profitability, up from 45% in 2014.

In last year's survey, investing in technology such as customer resource management software, forecasting and supply chain management tools to gain these efficiencies was on CFOs' agenda. Half (51%) of the CFOs responding to the 2014 survey said they would grow profits this way. In 2015, that number has dwindled to about one-third (37%). One reason is that previous investments may be paying off—or that simply CFOs are returning to their faith in better team management to achieve efficiencies (Figure 1.6).

Figure 1.6: Keeping it simple, straightforward
How will you improve profitability in 2015?



Underpinning the urge to grow is the ability to do it amid favourable financing conditions—so long as they last. Markets now are in a phase of anticipation. Everyone expects the US Federal Reserve to raise interest rates this year. But the cost of funding in debt markets is decidedly still favourable. Many Asian central banks have lowered interest rates in a phase of easing that has "decoupled" their policy from that of the US. Bank lending is cheap, but CFOs are also wary (as section IV. demonstrates), showing greater concerns over mounting leverage.

Living with volatility… but staying resolved

Achieving optimistic growth goals becomes that much more uncertain as risks (explored in section V.) build. More than half of Asia's CFOs (54%) cite financial market risk as their single greatest concern this year, up from 36% in 2014. Currency volatility as Asia aligns with the strengthening US dollar, a languishing euro and a weak yen is imposing cross-currents on company balance sheets, sometimes helping bottom lines, sometimes undermining them. China's government last year allowed new and surprising volatility in the value of the renminbi—a volatility that will almost certainly persist as the currency marches toward full convertibility.

"In some ways the field can be tilted against you. It makes you work a little harder. You see a chance to win, you take it."
Allen Lueth, VP Finance (China), Cardinal Health

But the risks also go beyond the financial. To take one example: China's aggressive anti-trust and anti-corruption campaigns, which have imposed strictures on foreign and local companies operating there alike. Costs continue to rise for China operations. Such obstacles are manageable, but they cannot be shrugged off.

"It's true, in some ways the field can be tilted against you," says Allen Lueth, vice president and finance director for the China subsidiary of Cardinal Health, a US healthcare services company. "It makes you work a little harder. You see a chance to win, you take it."

This confident tone is common: CFOs in Asia have encountered challenges that appear to strengthen their resolve, not subdue it. Some of this comes from hard-won experience, a legacy of the continent-wide currency crisis a generation ago and the establishment of durable risk-management practices. For multinationals it signals a greater confidence in the ability to innovate and compete in local markets.

CFOs are ready. "Volatility is nothing new to us," says Itochu's Mr Hachimura.

Case study

Tsuyoshi Hachimura, Itochu: Playing the long game in China

Itochu is strengthening its longstanding ties with China, the risks and opportunities of which it knows well

Something of the spirit of the overseas venture has always been in Itochu's corporate blood. Founder Chubei Itoh began as linen trader in 1858 around the time that Japan opened up after centuries of isolation. Since then, the trading company has fanned out across the world, with a wide-ranging portfolio of businesses that includes textiles, food, energy, technology, telecommunications, finance and many others. Itochu became the first general trading company in Japan to establish a trading relationship with China in 1972.

Itochu strengthened its longstanding links with China in January 2015, when the company announced that it would partner with Thailand's Charoen Pokphand (CP) Group in a US$10bn, 50-50 deal to buy a 20% stake in Citic Ltd, a Hong Kong-listed unit of the state-owned financial services conglomerate Citic. The deal followed a tie-up with CP Group in July 2014, when Itochu purchased a US$852m stake in CP Group's Hong Kong-based unit CP Pokphand Co, which produces animal feed in China and owns farms in Vietnam.

Initial press reports on the Citic transaction focused on the financial risk in the deal to Itochu. Rating agencies Moody's Investor Service and Standard & Poors placed the company on review for possible downgrade in the wake of the deal, because of its increased exposure to the Chinese market. Moody's has since ended the review and left the ratings unchanged. Some of the chatter died down in March 2015 after the sale by Itochu of its stake in PrimeSource Building Products, a North American wholesale building materials business, to US-based Platinum Equity, in a move to help finance the Citic deal. Itochu and Platinum did not disclose the deal size, which was reported by Nikkei as around ¥100bn.

Itochu is confident that it understands China risk, an outgrowth of its long strategic engagement with the country. "In order to grow together with Asia and China, there needs to be a level of partnership that is deeper and more engaging than there's ever been before," says Itochu's CFO, Tsuyoshi Hachimura.

"In order to grow together with Asia and China, there needs to be a level of partnership that is deeper and more engaging than there's ever been before."
Tsuyoshi Hachimura, CFO

Put another way, commitment to markets ahead of the pack is part of the company's ethos. "In a mammoth-sized market like China where the government is pushing the privatisation of companies—and where Citic is, basically, 'China'—the deal was a great opportunity for us to prepare the strategic structure to commit ourselves to the Asian and Chinese markets going forward."

He adds, "This is not to say that doing business in China is easy, nor that it will become easy." For one thing, he recognises that major investments in China are a two-way street. "China probably has expectations for Itochu to boost consumption within China and also help build stable and consistent availability of qualified goods and services in all parts of the country."

The China venture with CP Group coincides with the company's focus on funding its businesses via cash flow. Starting with a plan announced in May 2015, Itochu will "invest within the bounds of our free cash flow after dividend," Mr Hachimura says.

"Analysts have said that the Citic deal does not generate cash flow," he notes. "But we did not do it expecting we will build immediate cash flows from this one deal." He says that one critic characterised the deal as "obtaining a ¥600bn entry ticket to a theme park, but then upon entering you actually need to pay for every ride in the park." Maybe so, but, "this entry ticket is a premium ticket that cannot be easily bought just because you wanted to buy one," he says. The ticket ensures that Itochu will have access to the world's biggest growth market and the ability to do what it has done well before: produce sustainable cash flows.

"And whom is this investment for?" he asks. "Our shareholders of course."

II. Growth strategy: Expansion on the agenda

The organic growth option has never seemed better as CFOs are fortified by greater confidence in responding to market challenges

More CFOs in Asia name organic expansion (58%) than acquisitions (37%) when asked how their companies will most likely use surplus cash in 2015. But both figures are substantially up year-on-year—48% for organic growth and 24% for acquisitions, respectively, in 2014—signalling that CFOs see this year presenting important opportunities to grow by either method in Asia.

"We're using the cash on our balance sheet in building our capabilities and in creating and augmenting our intellectual property, as well as investing in infrastructure and capacity creation," says Pratibha Advani, CFO of India's NIIT Technologies. "We have been able to do all this through internal accruals and still have a healthy dividend pay-out track record. Inorganic initiatives are an important element of our growth strategy and if required we might consider debt financing."

Organic shake

The largest shows of enthusiasm for organic growth occur in countries where leverage is high, the currency is weak against the US dollar, and this type of expansion is simply the safest route to success. South Korea (2015: 73%; 2014: 46%), India (2015: 67%; 2014: 58%), and Malaysia (2015: 63%; 2014: 58%) showed the strongest preference, with difference between this year and last year the biggest in South Korea, at 27 percentage points (Figure 2.1).

South Korea's economy has healthy if not spectacular growth figures (expanding 3.4% in 2014, with unemployment at 3.2% by the end of the year), but the domestic market is aging and wage growth has been limited. Rising household debt has also constrained consumption. More Korean businesses are looking overseas in Asia, North America, and Europe via organic growth, although acquisitions are not completely off the cards (up to 31% in 2015, from 17% last year).

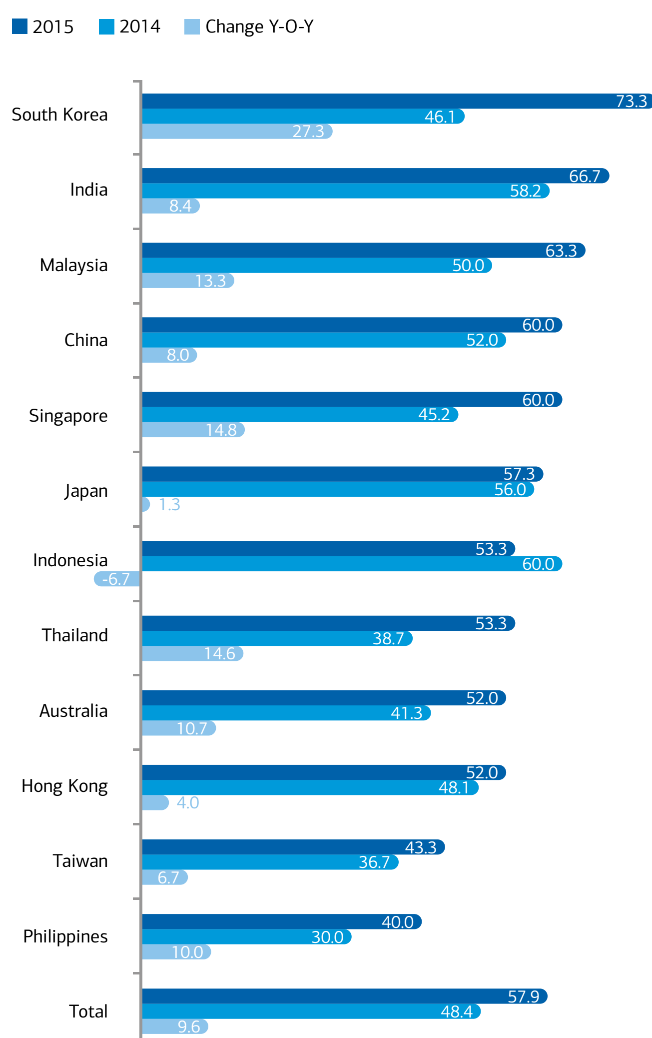
South Korea's bilateral free trade agreement with the US, which came into force in 2012, and progress toward a trade agreement with China have improved the prospects for cross-border expansion in two of Korea's largest markets. South Korea's biggest automaker, Hyundai, announced plans in March 2015 to build a second factory in the US to increase its already rising sales of SUVs there. Hyundai is also expected to speed up its localisation strategy in China by expanding production in China after the South Korea-China FTA is concluded.

As Ms Advani's comment implies, growing organically with available cash has been an ongoing strategy at her Noida-based firm. It's a sentiment she shares with other Indian CFOs. Indian companies are second only to those in South Korea to be targeting organic growth this year (67% plan to do so, up from 58% in 2014)—a reflection perhaps of optimism concerning the economic policies of the reformist prime minister, Narendra Modi.

Survey participants in China are also focusing more on organic growth this year (2015: 60%; 2014: 52%). Despite China's slowing growth, new markets are opening at a dramatic rate in second tier cities and through market segmentation.

Figure 2.1: The safest route to success?

% respondents planning to use surplus cash to grow organically; change year-on-year in percentage points



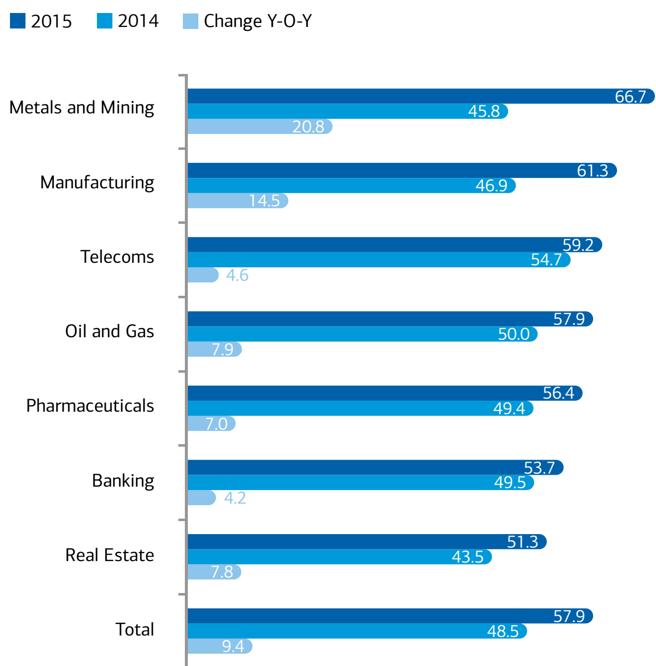
Grow—but carefully

NIIT, a technology solutions provider, has a client base that includes telecoms, pharmaceuticals and banking. Most of the service company's revenues come from providing solutions designed to extract value as companies enact organic expansion strategies. As such, NIIT faces a responsive market in its key sectors this year. A somewhat larger proportion of telecoms (59%; 2014: 55%), pharma (56%; 2014: 49%) and banking (54%; 2014: 49%) companies say they will grow organically this year than did so last year (Figure 2.2).

The biggest change over last year's survey by sector is perhaps a surprise. Some 67% of mining companies (2014: 46%) say they will focus on growing organically in 2015, a result that looks counterintuitive as commodity prices deflate. Yet the collapse in prices has prompted many miners to boost production, not slash it. The biggest companies are now amid a war to gain market share from rivals. BHP Billiton, with a fiscal year ending in June, is maintaining its guidance for 11% growth in iron ore production for the full year. Its rival Rio Tinto increased production by 11% in its financial year ending December 2014. Smaller companies in the sector that service the majors stand to grow in tandem, though there will be many that fail in their ambitions in such a challenging environment.

Figure 2.2: Battling for growth

% respondents planning to use surplus cash to grow organically
Select industries; change year-on-year in percentage points

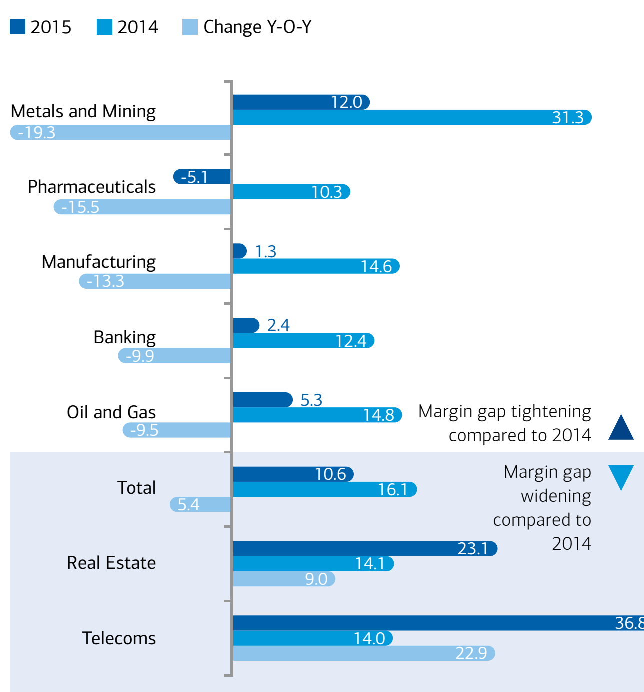


Wars to gain market share are notorious for widening the gap between revenue and profit growth, as companies increase costs to elbow out rivals. Yet the survey responses suggest that miners are making good on efficiencies, and expanding organically without an undue rise in costs. The so-called margin gap between revenue and profit expectations tightened considerably in metals and mining companies from 2014 to 2015 (Figure 2.3). In 2015 that gap stood at 12 points, substantially tighter than the 31 points in 2014. The result reflects recent victories in cost reduction. To take two examples, BHP slashed Western Australia iron ore production costs by 29% year-on-year for its fiscal first half ended December 2014. Rio Tinto took out A$1.2bn (US$917m) in operating costs related to operations and exploration and evaluation in 2014, compared with 2013.

The preference for organic growth in the manufacturing sector (2015: 61%; 2014: 47%) is also significantly higher this year, but less surprising. It suggests that manufacturers in Asia, despite worries about slowing local economies (see section II.), are looking to build on gains following several years acquiring new assets throughout the region to tap the buying habits of the region's rising middle-class consumers.

Figure 2.3: Marginal improvement

Difference between proportion expecting revenue and profit growth
Select industries; percentage points



Innovation meets "brass tacks"

Global companies with operations in Asia are also concentrating on their ability to respond more quickly to market challenges, in a growth phase in the region of which the defining characteristics are the rise of competitive local companies and fierce battles for market share. The proportion of CFOs at multinationals who say that innovation in new business lines is a focus for Asian operations this year has grown to 56% from 42% in 2014. By sector, the figure is highest in telecoms (71%), manufacturing (64%) and metals and mining (63%; Figure 2.4). Substantially fewer respondents in each of these sectors last year named this as a main goal (telecoms: 56%; manufacturing: 51%; metals and mining 32%), suggesting that falling prices and intensified local competition is prompting MNCs to re-evaluate marketing, distribution and operational models to adapt to the speed of change in Asia.

Simultaneously, the focus on best financial practice has grown dramatically. The "brass tacks" of producing profitability are in vogue this year. In 2015, driving profitability by working capital management (70%), operational efficiencies (56%), and increasing capex (54%), are followed by using tech and advanced software to achieve better results (37%). Last year, using technology to drive profits led the responses at 50% (Figure 2.5).

Metals and mining companies are focusing on direct cost reduction in operations. But they share with their other industry-sector colleagues a drive to protect cash flow via better working capital management. The strongest responses by CFOs who say they will grow profits in this way are in oil and gas (2015: 78%; 2014: 36%), metals and mining (2015: 77%; 2014: 26%), and real estate (2015: 76%; 2014: 45%; Figure 2.6). As with metals and mining companies, oil and gas firms face the shock of lower prices, and are looking to better working capital management to facilitate a greater flow of cash to operations. Property businesses are facing an overvalued real estate market in most of Asia. If interest rates rise this year their finance costs will rise, too, calling for greater access to freed-up cash to service debt repayments.

Figure 2.4: Keeping up with the competition
% respondents picking "innovate in new business lines" as a main goal for Asia operations
MNCs only

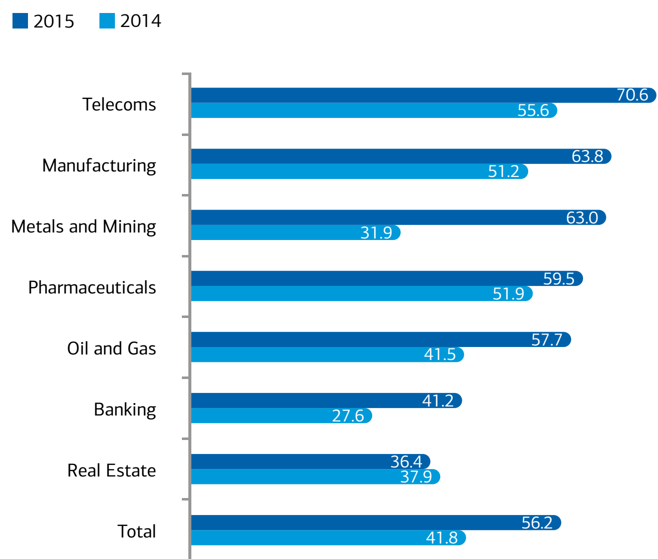


Figure 2.5: Extracting value, by any means
Means to improve profitability in coming year

Means to improve profitability	Rank 2015	Rank 2014	Change
Working capital management	1	3	▲
Operational efficiencies	2	2	--
Capital expenditure	3	4	▲
Technological advances (e.g. forecasting, CRM, supply-chain management)	4	1	▼
Tax optimisation	5	6	▲
On or offshoring functions	6	7	▲
Headcount reductions	7	5	▼

Cardinal Health's Allen Lueth sees funding and liquidity management as an on-the-ground affair, involving the same vigilance as any market. Cardinal is a net borrower in China, funding primarily with local banks, so understanding the system and developing relationships is a core competence. Simple, practical skills such as speaking Putonghua become indispensable. Understanding the labyrinthine state hospital system and ensuring timely payments becomes a specialised task. Better working capital supports cash flow, allowing his team to focus on service, a driver of growth in an increasingly competitive market. "We're a service company. It's the only long-term sustainable way to differentiate," he says.

The push for better working capital management comes in tandem with less interest in investing in technology to build efficiencies. About a third (37%) of CFOs say they will increase profitability by investing in advances in automation such as forecasting, CRM, and supply chain management tools, down from 51% last year. The finding may reflect cheaper cost saving technologies available via cloud computing and other rapidly adopted innovations are beginning to make their mark.

It also underscores CFOs' focus on tighter management controls. Michelle Liu, CFO for Greater China for German chemicals firm Lanxess, speaks of an intensification of all basic techniques to improve working capital and efficiency performance.

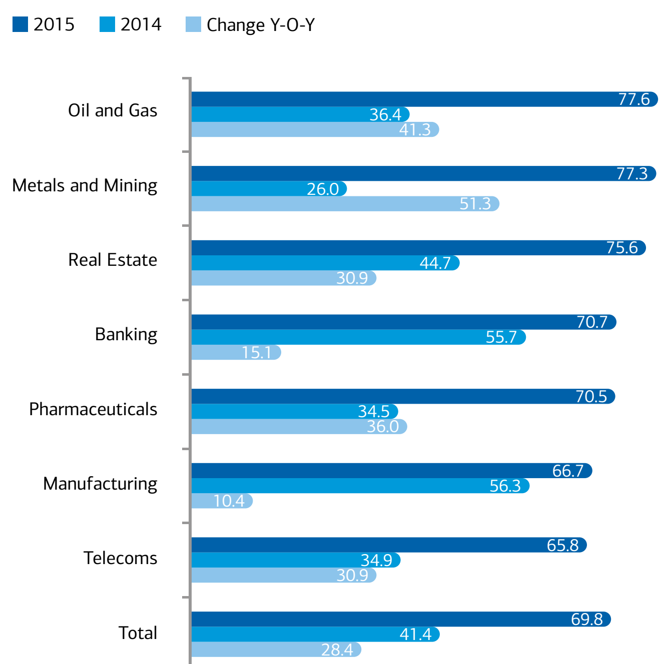
"The determining factor is not about what advanced technology or tools are being applied in this respect from our local practice," she says. "But to employ the right mentality and discipline consistently within the organisation. Usually when the market is booming, very few people care about spending or working capital costs. When you talk to your procurement or sales people there is not much urgency or pressure over such financial disciplines. But under the current tougher economic situation, it's easier to come to common understanding that we have to keep closer eyes on the overall process of cost, and pay more attention on the financial KPIs."

Ms Liu says that Lanxess has integrated sales and financial KPIs for sales and operational teams in face of the ever-increasing competitive market in China, where especially in certain segments rising low-cost competitors are adding significant supply capacity. "This is the general market condition in China, and we have to face and deal with it," she says.

"As head of finance I am responsible for working capital management—so I'm bugging the inventory guys all the time."
Lawrence Kwan, Finance Director, Asia-Pacific, Univar

Lawrence Kwan, China based finance director for the Asia-Pacific region at Univar, a US-based chemicals distributor, says that inventory control has become the more important aspect of working-capital management in the highly competitive mainland market. Proper controls allow Univar to make available a full menu of specialty products, but must also be arranged to limit costly excess inventory days. "It's the crucial part of working capital management for us," says Mr Kwan. "As head of finance I'm not directly in charge of inventory, but I am responsible for working capital management—so I'm bugging the inventory guys all the time."

Figure 2.6: Back to basics
% respondents seeking to improve profitability through better working capital management
Select industries; change year on year in percentage points

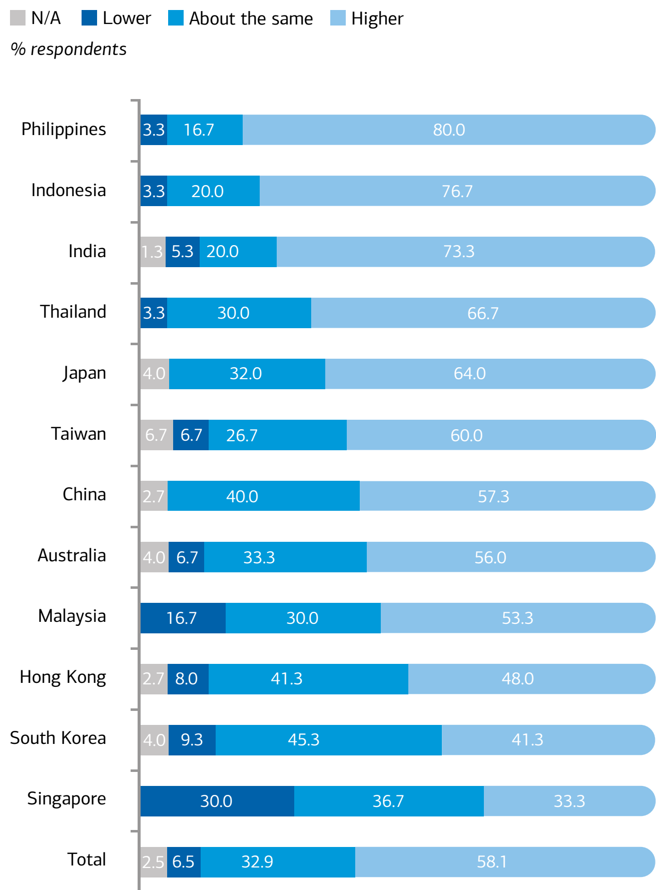


Still spending it

Surprisingly, CFOs in Asia are still thinking about growing capex—while it's affordable to do so. A small majority of CFOs (58%) say that they expect their company's capital expenditure to be higher this year than in 2014, reflecting the current opportunity in the market to obtain funding at lower rates ahead of any expected move by the US Fed (Figure 2.7). Many Asian central banks, including the People's Bank of China, have reduced rates in the first quarter of the year, making raising funding locally a still-attractive option, but their ability to continue easing in the future—with the US going in the opposite direction—will be constrained as regional currencies come under pressure. So striking now, while the iron is hot, makes sense.

Some 73% of CFOs responding from India say they will increase capex this year, in part with current optimism in the business environment there as Prime Minister Narendra Modi's administration tackles economic reforms.

Figure 2.7: Against the grain?
Expectations for capital expenditure in 2015 compared to 2014



Circumspection in China

In line with concerns reported about China's tougher business environment, multinationals' investment in China operations is not off the cards, but enthusiasm has dropped. The proportion of CFOs at MNCs who say their companies are thinking about moving some production/operations from China to elsewhere in Asia has grown to 47% in 2015, from 43% who considered the possibility or did so last year (Figure 2.8). Meanwhile, 37% are thinking about cutting headcount in China, up from 28% who considered this in 2014.

Mulling a substantial move from China is one thing. Doing it is another. Companies have been placing their bets elsewhere in Asia as a diversification from China risk for years. Dealing with rising labour costs, seemingly arbitrary enforcement of regulation and tax law, polluted air, and the ongoing effective (if somewhat frightening) campaign by the government of Xi Jinping to stamp out corruption in the Communist Party ranks continues to daunt foreign CFOs in China.

"Obviously, regulatory risk is a key risk in our business," says Jason Fogden, Asia CFO for Syngenta, a Swiss-based agribusiness giant. "Our reaction has been to base our argument on science. We engage quite heavily with regulatory bodies in China, try to gain understanding and influence through public forums and university studies."

Discomfort is visible in this year's survey, but will it necessarily lead to a major shift from China? Other results from the survey, and common sense, suggest not. After all, 45% of CFOs at MNCs say they are considering investing in additional production/operations in China in 2015 (albeit down from 55% in 2014). Elements in China's environment are irreplaceable. Other than India, China is the only continent-sized market in Asia. And although Modi fervor has prompted CFOs to eye Indian reforms, the jury is still out and the environment for business there is still difficult. Moreover, infrastructure in China has developed remarkably fast, with visible improvements such as the nation's high speed rail system emerging year by year. The skill sets of local workers are steadily moving up the value chain. And lower cost markets are still within reach in China's west.

Figure 2.8: China caution?
Changes to China strategy among MNCs

"Our motto is 'follow the customer'. We are adding stores where Chinese tourists travel."
Bruno Li, CFO, Trinity

China concern is real, though. Very likely, it is an outgrowth of current political and economic shocks resulting from structural reform. CFOs may be just as inclined to roll up their sleeves and wait it out.

To be sure, many companies are holding fire in China for now. Bruno Li, CFO of Hong Kong based Trinity, says that it has put adding new stores in China on hold for this year. However, it is growing elsewhere—to capture its customers from China buying overseas, where its products are at a discount, sometimes as steep as 30%, due to high import duties and VAT tax imposed by China on its premium products. Meanwhile, more wealthy and middle class tourists are traveling overseas from China, into South-east Asia, North America, and Europe. "Our motto is 'follow the customer'," says Mr Li. "We are adding stores where Chinese tourists travel."

But he says, "We will grow in China again."

Case study

Jose Teodoro K. Limcaoco, Ayala Group: Where to spend it

Ayala has positioned its businesses to tap the new buying power of the Philippines' rising middle class

Prior to his appointment as CFO of Ayala Group in December 2014, Jose Teodoro K. Limcaoco was President of BPI Family Savings Bank, the consumer banking arm of Bank of the Philippine Islands, one of the largest commercial banks in the Philippines and the foremost of the Ayala conglomerate's holdings in financial institutions. An Ayala veteran, he has also served as President of BPI Capital Corp, the investment arm of the bank, and as finance chief of several Ayala companies, including Azalea Technology Investments, a tech incubator fund in the group.

This consumer finance pedigree makes Mr Limcaoco the ideal finance leader for the group's 2015 expansion. Mr Limcaoco sees an almost unprecedented window of opportunity for domestic growth in Ayala's businesses, and attractive finance options to support it–for now. "As a group, we have a lot of confidence in the consumer sector, which touches most everything we do," he says. "The government is predicting 7% GDP growth for 2015—it may be that we actually see it do better than that, possibly up to 8%."

The Philippines has outperformed average GDP growth for South-east Asia since 2012, the result of a number of factors that emerged under reforms introduced by President Benigno Aquino III, (including a boost in the sovereign credit rating based on confidence in the government's stewardship) that have stimulated foreign and domestic investment. Consumer buying has accelerated, and a lively services sector is growing. "We're doing most of our positioning this year in the consumer sector, which we see as the major driver in the economy," says Mr Limcaoco.

Ayala has earmarked P185bn (US$4.2bn) for total capex in 2015, with the biggest portion P100bn allotted for its real estate unit Ayala Land. The subsidiary aims to invest in more residential, office, hotel and commercial centre projects, as well as make new land acquisitions for future projects. Another P37bn has been set aside for Ayala's Globe Telecom, mostly to support upgrades for its network infrastructure to enhance its Globe data-related offerings. The parent group, which oversees infrastructure projects, is deploying P21bn to support investment programmes in power generation and transport infrastructure.

> *"There was a tendency to front-load capital raising in 2014. Businesses were expressing some concern over the elections. But that has lightened now."*
> Jose Teodoro K. Limcaoco, CFO

Ayala's businesses raised a total of P26bn in new equity in 2014, and Mr Limcaoco says that the group and its subsidiaries may return again to the still buoyant stock market, but with a wait-and-see approach. "If we see a good opportunity to raise US$200 to US$400m, then we'll pull the trigger," he says. "But we'll rely on debt more." The reason is that lending rates are still attractive, and he sees slightly higher rates at the end of 2015, not a major move. Speaking of the effect of a rise in rates on Ayala's real estate customers, he is equally relaxed. "Even if they rise by 100 or 150 basis points, it's not really going to do any harm," to buying sentiment, he says.

The wait-and-see financing approach is in keeping with a transition year, which 2015 will almost certainly be for the Philippines, with President Aquino's term ending in 2016 and the onset of a new presidential election (presidents are restricted to a single six-year term under Philippines law). The Philippines' history since the EDSA, or People Power, revolution in 1989 has been turbulent, with several unstable administrations undermining confidence in the economy. President Aquino's anti-corruption initiatives and efforts to stabilize the nation's finances restored confidence, but the sentiment is still fresh, even with finance veterans like Mr Limcaoco.

"There was a tendency to front-load capital raising in 2014. Businesses were expressing some concern over the elections," he says. "But that has lightened now."

What has changed? Nothing—and perhaps that's the point. National growth has been reliably climbing for four years, a fresh experience for the nation in the post-Marcos era. "None of the major houses are pulling back on investment," Mr Lamcaoco says. "There's a sense that the reforms will continue," if only because they have proven to be a catalyst of growth, and voters will be reluctant to see them undermined.

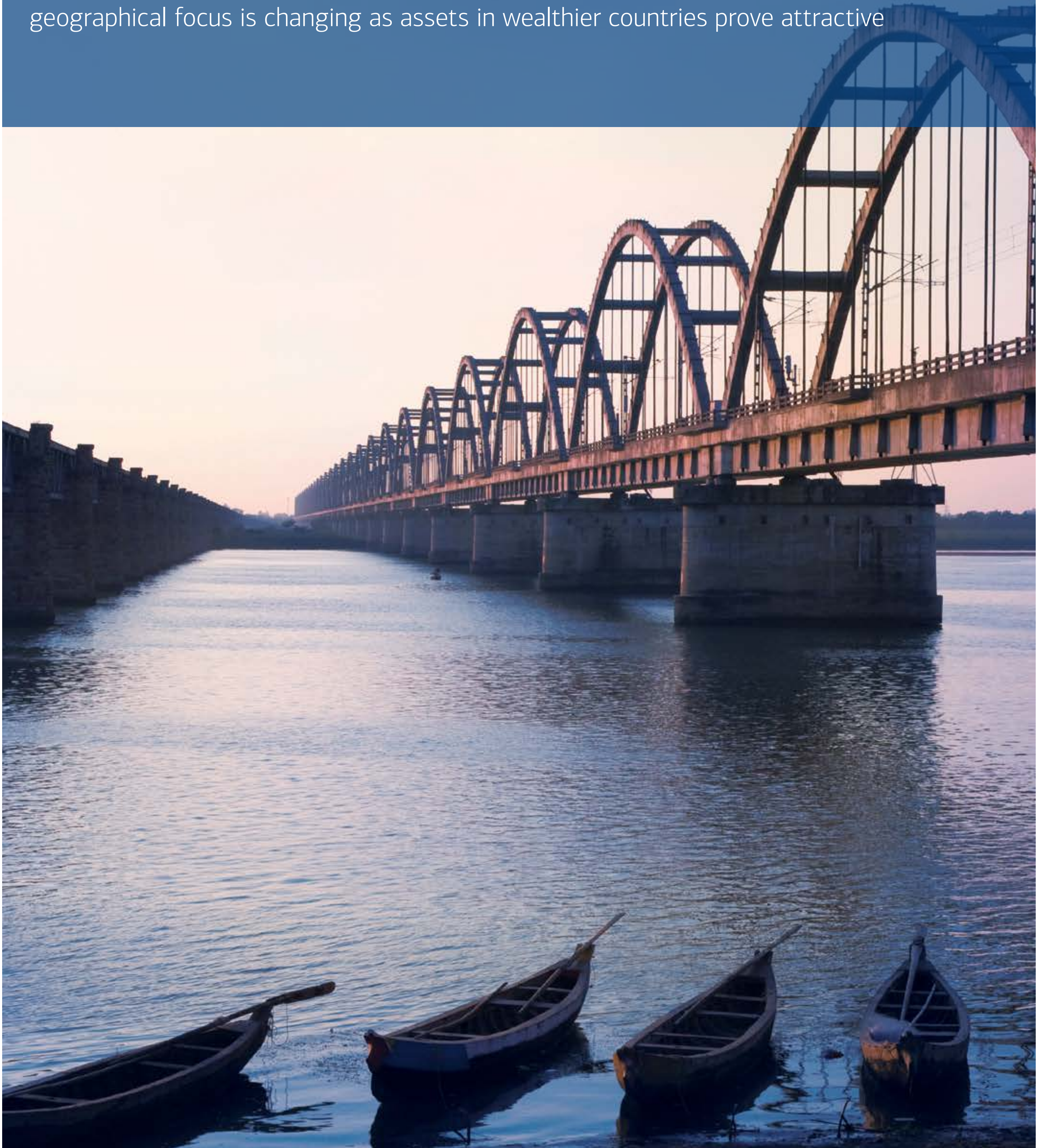
His banker's perspective informs his cautious optimism. "The BSP [Bangko Sentral ng Philippines, central bank] worries a lot about an asset bubble, but they've been proactive in controlling bank lending standards. No one sees an asset bubble—yet," he says.

Meanwhile, growth is on Ayala's agenda, without reserve. In the first week of April 2015, Ayala confirmed it was interested in bidding for development work on Manila's Aquino International Airport. The same week Ayala Land made its first cross-border investment in South-east Asia, buying 9% stake in Malaysian company GW Plastics Holdings Berhad via a private placement of US$43m.

"It's a good time to be a CFO," Mr Limcaoco says.

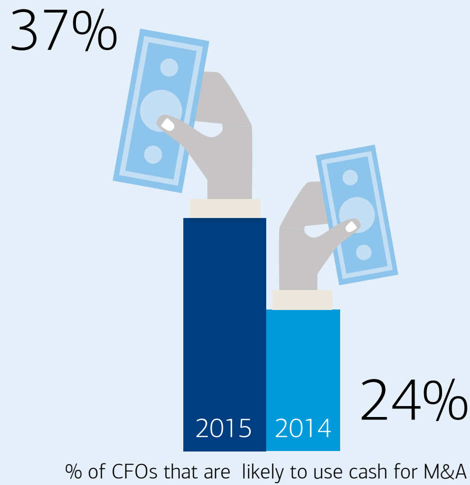
III. M&A: The boom continues?

Amid an M&A boom, more CFOs in 2015 see opportunities to buy growth, but their geographical focus is changing as assets in wealthier countries prove attractive



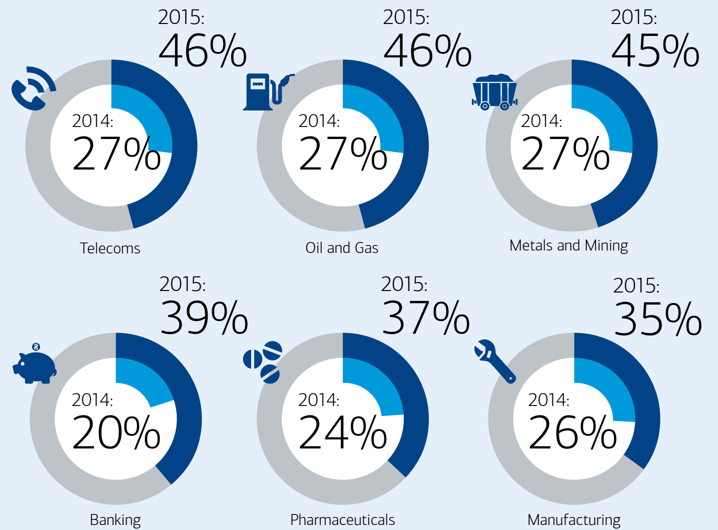
Deal fever

The appetite for M&A has risen in Asia, as companies sit on cash piles and markets stay favourable—for now.



Who's most acquisitive?

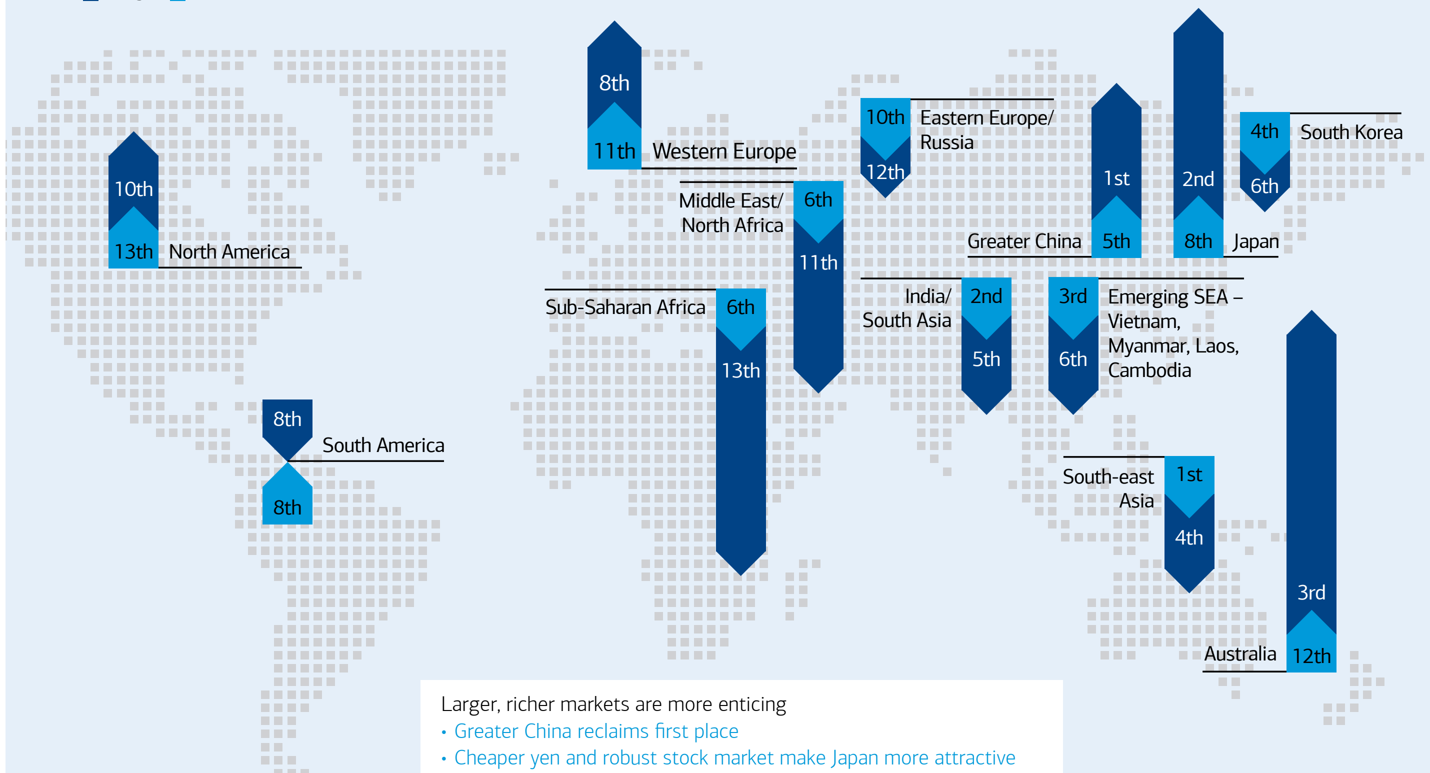
% of CFOs that are likely to use cash for M&A



New targets, fresh game...

Ranking of target M&A markets

2015 2014



Larger, richer markets are more enticing

- Greater China reclaims first place
- Cheaper yen and robust stock market make Japan more attractive
- Weak dollar and struggling industries make Australia more enticing for buyouts
- The allure of South-east Asia softens as volatility rises and political uncertainty persists

M&A is in season. Amid an acknowledged M&A boom, investment opportunities abound throughout the continent, and the strong region-wide M&A activity has whetted CFOs' appetites. Thirty-seven percent of CFOs responding to this year's survey say they will use excess cash for acquisitions, up from 24% last year (Figure 3.1). Among Asia's larger markets, there are notable rises in M&A appetite among CFOs based in India (69%, up from 22% last year) and China. Likewise, respondents from India and China were among those most likely to answer "acquisitions" when asked the reasons they would seek financing this year (55% and 32%, respectively, versus 18% and 20% in 2014; Figure 3.2).

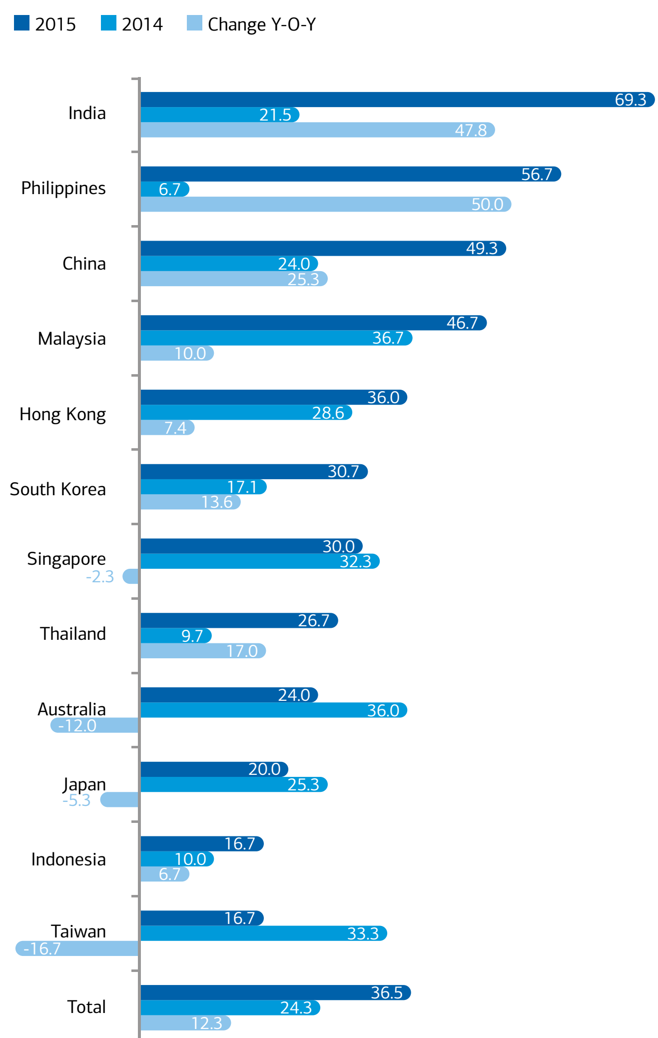
Companies in the region will find it hard to beat last year's volumes of deals. Announced M&A in the Asia-Pacific region totalled US$716.2bn in 2014 according to Thomson Reuters, up 59% from 2013 and the highest total ever.[2] Despite concerns over the difficulty of China's business environment, it was a record year for M&A there, too, with announced deals up 89% to US$390.4bn. Announced deals in South-east Asia grew 44% to US$87.2bn, while the value of deals in South Korea grew 55% to US$65bn. M&A in Australia was up 7% to US$81.2bn. Japan was the only major market to show a decline. Announced deals there dropped 17% to US$64.9bn.

If the appetite for acquisitions in Asia is stronger, the geographical emphasis is changing. A ranking of the most preferred target regions and countries for acquisitions this year shows big change toward richer countries in the region. CFOs named Greater China (36%), Japan (35%) and Australia (28%) as the top destinations, with South-east Asia, the top-ranked destination last year, in fourth place (27%) and India/South Asia in fifth (25%—Figure 3.3). At the same time, Western Europe and North America have both increased in attractiveness for Asian acquirors.

South-east Asia has become less attractive as a target for M&A as growth slows and classic structural issues impeding business prove difficult for governments to solve quickly. Meanwhile, financing on a global basis is still cheap, the US dollar is strong, and Asian currencies are depreciating. That has put assets in richer North Asian economies—China, Japan and Australia—within reach of ambitious acquirers. In addition, some of Asia's legacy companies—Hong Kong's Hutchison Whampoa and Cheung Kong Holdings, to take one example—are using M&A to rationalise their business structures and prepare for a next generation of growth.

Figure 3.1: Cash burning a hole in the pocket

% respondents planning to use surplus cash for acquisitions
Change year-on-year in percentage points



[2]Thomson Reuters, Mergers & Acquisitions Review, Financial Advisers, Full Year 2014, December 2014. Available at http://share.thomsonreuters.com/general/PR/MA-4Q14-%28E%29.pdf

Figure 3.2: Mortgage mania

% respondents planning to use financing for acquisitions
Change year-on-year in percentage points

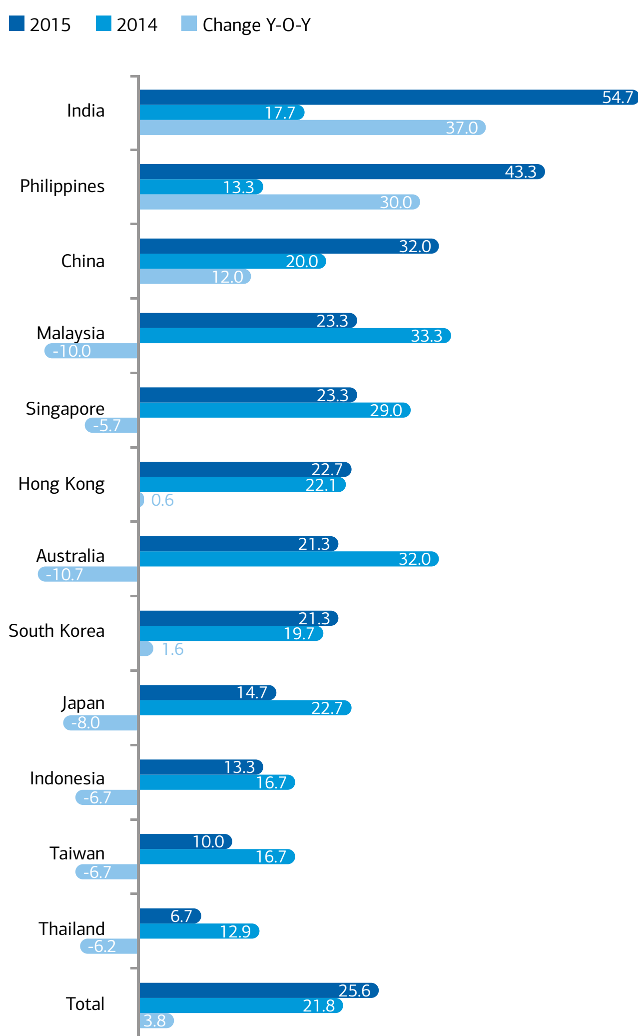


Figure 3.3: Shifting M&A priorities

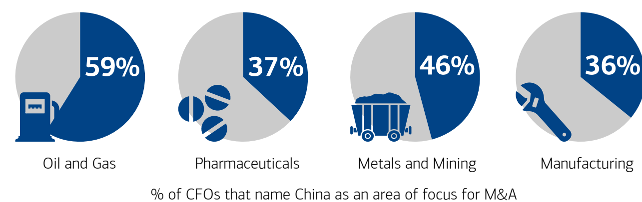
Regions respondents are focusing on most for M&A in 2015, by rank

Country	Rank 2015	Rank 2014	Change
Greater China	1	5	▲
Japan	2	8	▲
Australia	3	12	▲
South-east Asia	4	1	▼
India/South Asia	5	2	▼
South Korea	6	4	▼
Emerging SEA - Vietnam, Myanmar, Laos, Cambodia	6	3	▼
Western Europe	8	11	▲
South America	8	8	--
North America	10	13	▲
Middle East/North Africa	11	6	▼
Eastern Europe/Russia	12	10	▼
Sub-Saharan Africa	13	6	▼

Figure 3.4: Area of focus for M&A, by country

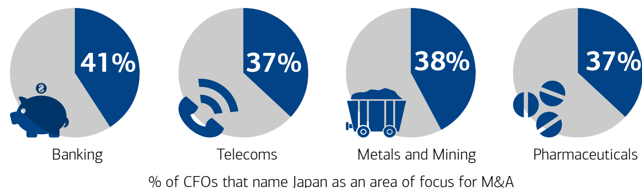
% respondents

In China...



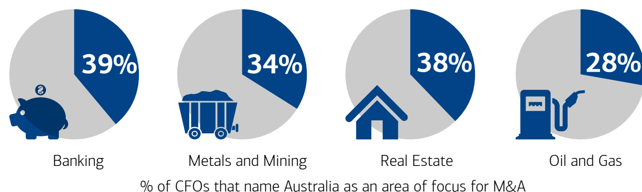
% of CFOs that name China as an area of focus for M&A

In Japan...



% of CFOs that name Japan as an area of focus for M&A

In Australia...



% of CFOs that name Australia as an area of focus for M&A

Why China, why now?

As mentioned in section II, CFOs have expressed growing caution about China due to concerns over slowing growth, rising local competition and regulatory risk. It may be seen as surprising, then, that Greater China reclaimed its place as CFOs' top destination for M&A this year. Yet companies' region-wide search for growth in the face of growing uncertainty in home markets is sustaining interest in the country, despite local challenges. China simply offers the largest market for expansion in the region, and the number and size of deals there dwarf those in other markets. Last year China saw its highest full-year M&A volume on record despite persistent concerns about macroeconomic trends.

"China's growth cannot be ignored," says Frankie Liu, Shanghai-based CFO for US diversified materials and technology firm Carlisle Companies Incorporated. "We review our China strategy, and have moved some production from China, but we have also opted to stay in China for many reasons including production and continue to look for M&A opportunities here. We see a commitment to China's market as a key to Asian growth." (See also the case study on page 38)

Some of the biggest recent deals targeting assets in China are long-term plays by Asian companies. In January 2015, Japan's Itochu and Thailand's CP Group announced the purchase of a US$10.4bn stake in CITIC, a state-owned investment company. In Itochu's case, the 50-50 deal underscored its long-term commitment to China and its desire to continue building on decades of experience there (see the case study on page 18).

"China's growth cannot be ignored... We see a commitment to China's market as a key to Asian growth."

Frankie Liu, CFO, Carlisle Companies Incorporated

Domestic consolidation in slowing markets is also a driver of M&A activity. Consider the slowing real-estate market: in March Shanghai Jingfeng Investment and Greenland Holding Group merged in a deal worth US$10.6bn, one of the biggest ever property deals in China. The two are affiliates and the deal allowed Greenland a back-door listing on the Shanghai stock exchange, a step it needs to fund its overseas ambitions.

Such deals reflect pressures in China to lock in future growth in the face of a slowing domestic market. The combination of more modest growth expectations (at least in relative terms), heightened competition, and a high degree of leverage in many sectors makes for a volatile mix that isn't for the faint-hearted CFO. But there are many that embrace the challenge.

"We're always on the lookout for good acquisition prospects, as China is a growth market for us," says Lawrence Kwan, finance director for the Asia-Pacific region of Univar, a US-based chemicals distributor.

Another element that accelerated deal-making involving Chinese companies last year was the more aggressive participation of non-state-owned companies. Previous major players in M&A were typically state-owned, but cash-rich private sectors firms have accelerated their interest in China deals or in cross-border acquisitions.

"We're always on the lookout for good acquisition prospects, as China is a growth market for us."

Lawrence Kwan, Finance Director, Asia-Pacific, Univar

The environment for M&A involving state-owned enterprises is improving too. The China Banking Regulatory Commission in March eased ending regulations applying to M&A, lengthening the allowable terms for loans for M&A to seven years from five, and raising the share of bank lending in such financing to a maximum of 60% of the total deal price, from 50%. The relaxation of bank lending rules is meant to help consolidation in state owned industries burdened with overcapacity as the national market slows.

M&A's rising suns

Assets are for sale in Japan, too—perhaps another surprise given the prospects for growth there are relatively weak, despite the best efforts of Prime Minister Shinzo Abe and his team. But Japan is still the second-biggest economy in Asia, and one in which asset prices have plummeted in foreign currency terms as the value of the yen has fallen, thanks to the aggressive monetary policy aspects of "Abenomics". And there are still opportunities for many sectors: Japan (together with China, which also has an ageing population) is equal top of the list as a target for M&A among CFOs at pharmaceutical companies in Asia, and it is also top for banking (Figure 3.5).

Figure 3.5: M&A opportunities by sector

Top five (of 13) regions respondents are focusing on most for M&A in 2015

Split columns and "--" indicate equal ranks

<table>
<tr><th>Rank</th><th>Banking</th><th colspan="2">Manufacturing</th><th colspan="2">Metals and Mining</th><th>Oil and Gas</th><th colspan="2">Pharmac-euticals</th><th>Real Estate</th><th>Telecoms</th></tr>
<tr><td>1</td><td>Japan</td><td colspan="2">Greater China</td><td colspan="2">Greater China</td><td>Greater China</td><td>Greater China</td><td>Japan</td><td>Australia</td><td>India/South Asia</td></tr>
<tr><td>2</td><td>Australia</td><td colspan="2">Emerging SEA - Vietnam, Myanmar, Laos Cambodia</td><td colspan="2">Japan</td><td>India/South Asia</td><td colspan="2">--</td><td>Japan</td><td>Japan</td></tr>
<tr><td>3</td><td>Greater China</td><td>Japan</td><td>West-ern Europe</td><td>Aus-tralia</td><td>South -east Asia</td><td>Western Europe</td><td colspan="2">South-east Asia</td><td>Greater China</td><td>Greater China</td></tr>
<tr><td>4</td><td>South-east Asia</td><td colspan="2">--</td><td colspan="2">--</td><td>Japan</td><td colspan="2">South Korea</td><td>South Korea</td><td>South Korea</td></tr>
<tr><td>5</td><td>India/South Asia</td><td colspan="2">South-east Asia</td><td colspan="2">Emerging SEA - Vietnam, Myanmar, Laos, Cambodia</td><td>Australia</td><td colspan="2">Australia</td><td>India/South Asia</td><td>South-east Asia</td></tr>
</table>

In Japan, companies with strong cash reserves and low leverage are also looking for consolidation gains by teaming up with, or taking over, weaker rivals. The process, however, is slow. Deals built on consolidation necessarily involve gains from synergies, implying savings from job cuts, a sensitive issue in Japan. For instance, although convenience store operators Family Mart and UNY Group in March set a completion date for their US$5.4bn merger—a deal that would create the second largest such company in Japan—crucial aspects such as business structure and strategy are yet to be agreed. These will need clarification before shareholder approval of the deal, which would bring consolidation to a sector where capacity is high and competition intense.

The weak yen has made real estate a buyer's market in Japan. China's Fosun made a foray into Japanese real estate in 2014, buying two office towers in Tokyo in the second half of last year, after acquiring homegrown Idera Capital Management in May for an undisclosed price. Fosun bought the properties through its new subsidiary. The company says that it is planning more property acquisitions in Japan, spending up to ¥10bn (US$94m). Singapore's sovereign wealth fund GIC splashed US$1.7bn to buy prime office space in Tokyo's Pacific Century Place Marunouchi building in central Tokyo in October.

Similar to Japan, a weak dollar in Australia has elevated that nation's attractiveness for M&A for survey respondents, with 28% citing Australia as a focus for M&A activity, compared to only 5% last year. The Australian commodity boom has peaked, as demand from its biggest customer, China, ebbs. Falling commodity prices, led by the collapse of the iron ore and coal, have opened opportunities for enterprising companies. The phenomenon has opened opportunities not only for minerals and mining companies: Asia CFOs from financial services firms (39%) and real estate companies (38%) are eyeing Australia, too. None in either category named Australia as a focus last year.

The end of Australia's mining boom is an interesting addendum as foreign tech companies have begun to seek reverse takeover opportunities through troubled mining-related businesses listed on the Australian stock exchange. There were 26 so-called back-door listings on the ASX in 2014, with about half of them technology related businesses "reversing" into mining company shell listings.

Meanwhile, the government is pushing to fund an upgrade to the nation's infrastructure and has put an unprecedented number of state assets on the block, from power facilities to ports. Lengthy approval processes for cross-border deals by state governments—the go-ahead for Indian conglomerate Adani's 2011 deal to develop a new coal terminal at Abbott Point is still stalled in Queensland amid environmental concerns—can make privatisation deals less attractive, yet sales are expected to accelerate.

The shifting geographical focus to North Asia is running simultaneously with a trend for internal restructuring leading to mergers in the region. Hutchison Whampoa and Cheung Kong Holdings, two assets majority owned by one of Asia's richest people Li Ka-shing, announced in January 2015 that it would merge in an effort to rationalise its businesses and provide a clearer value opportunity for shareholders. Meanwhile, Korean behemoth Samsung is amid a group-wide restructuring as its family owners plan a succession to the next generation that may include mergers to rationalise the company's sprawling holdings. In November 2014 the company called off a US$2.3bn planned merger of its shipbuilding and engineering units amid pressure from shareholders. But more merger activity is expected.

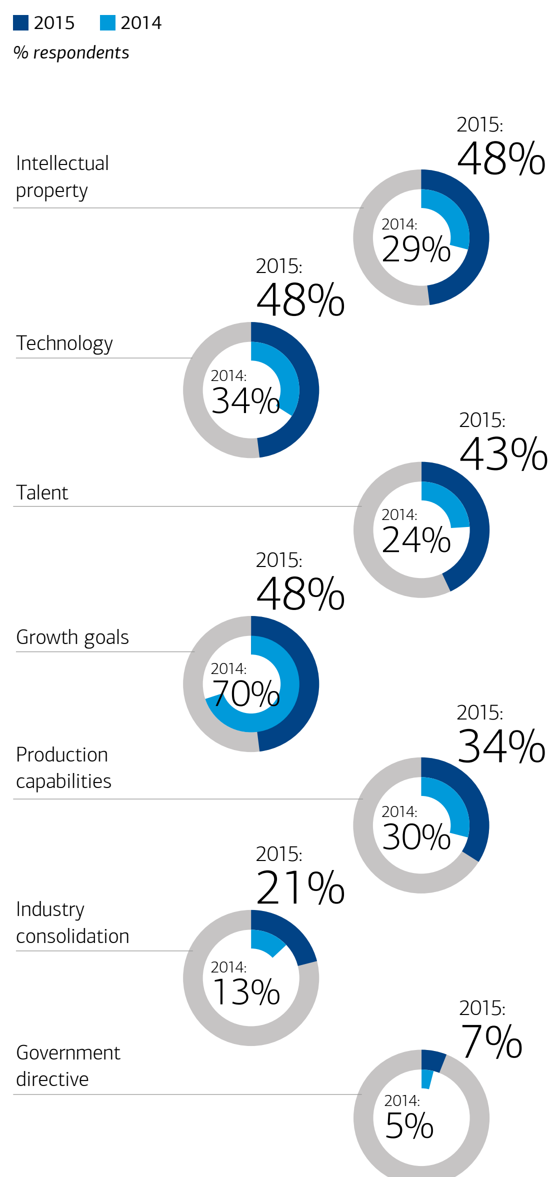
Acquiring the tools to grow

Some drivers of the region's M&A are only surprising in that they have intensified over the past year. The acquisition of intellectual property, technology and talent have become more important as motives for M&A, while buying simply to grow (e.g. to acquire market share) has become less important (Figure 3.6). About half of CFOs in 2015 say that a primary driver for acquisitions will be buying intellectual property or technology (48% in both cases). This is up from a response of 29% for intellectual property and 34% for technology last year. CFOs in India gave the strongest responses regarding acquisitions with technology as a driver (59%), while 57% of CFOs from Indonesia cited this as a motive for buyouts.

Mr Liu of Carlisle describes the company's October 2014 acquisition of a Singapore medical cable producer LHi Technology for US$200.7m (see the case study on page 38) as a way to bolt on a new technology to the company's interconnected technologies division. The purchase has simultaneously boosted Carlisle's presence in healthcare technology and given it access to markets in South-east Asia, and a new production facility in Shenzhen, China. "The market for medical components is now very strong—globally and in Asia. With the LHi acquisition, we get access to that growth now," says Mr Liu.

Carlisle's Singapore purchase has bucked the trend. On average this year excitement over South-east Asia, favoured last year due to high growth prospects and low valuations, has waned. But Mr Liu is upbeat. "There are many reasons that contribute to an M&A decision—and in Asia you have to be especially vigilant about understanding opportunities and risks. We're still looking everywhere," he says.

Figure 3.6: Reasons to buy
Main motive for acquisitions



Case study

Frankie Liu, Carlisle Companies: China is the hub

Carlisle Companies is adjusting to change in China, but sees advantages to headquartering its Asian finance operations there

Carlisle Companies has made the best of diversification, and it has done so by making careful and decisive calls on when to enter some markets and when to exit others.

A simple description of the business of this North Carolina-based company presents a study in variety: a global diversified conglomerate that designs, manufactures and markets a wide range of products that serve a broad range of niche markets including commercial roofing, energy, agriculture, lawn and garden supplies, mining and construction equipment, aerospace and electronics, dining and food delivery, and healthcare.

"The environment has changed here, but in our view China is still the global growth engine and you have to grow and adjust as China grows." Frankie Liu, CFO

The unifying factors in the company's business are an understanding of value unlocked in niche markets, and when it's time to exit. Carlisle divested its transportation products division at the end of December 2013. In October 2014 it bought a Singapore-based medical cable maker, LHi, from private equity firm 3i. Several months later, it sought to acquire the liquid finishing division of Graco, a US maker of fluid handling systems.

The US$200.7m LHi acquisition was driven by Carlisle US corporate, but the ultimate benefits and business expansion will be in the Asia region, particularly for China, where Frankie Liu, Carlisle's Asia CFO, runs regional finance from Shanghai.

Carlisle made a considered decision about staying in China and running regional financial operations from there. "The environment has changed here, but in our view, China is still the global growth engine and you have to grow and adjust as China grows," says Mr Liu. "We have many customers and in many sectors," he adds, "and we have to be here to make the most of this." China's developing aerospace industry is one such customer. "Some of our customers in this industry are in tier-one cities. Some are shifting to tier-two and tier-three cities. We want to be here to capture the business opportunities."

"Our commitment to China is very strong. We like this country," he says. True, but all the same, Carlisle has made and is still making major adjustments there, in part due to the growing cost of labour in China's eastern coastal manufacturing centres. In 2012, ahead of the sale of the transportation products division, it moved production from Shenzhen to the rural city of Meizhou. In 2013, Carlisle's food service division moved some production from Changzhou in China to Oklahoma in the US, using automation lines to cut costs and improve overall production capacity.

"You have to constantly analyse the cost rationale of your strategies in China, but think through the consequences of change carefully," Mr Liu says. "Two years ago we shut down production Shenzhen and Changzhou in this unit and moved, mainly for looking for the ways of minimize or offset pressures of growing labour costs. In other businesses, we opted to stay in China and adjust. There are advantages to being close to our China markets—because the market is so important to us."

The decision to purchase LHi, which is a global market leader in its niche of medical cables and other devices, was a collaboration between Carlisle's M&A strategy team based in the US and Mr Liu, who was in charge of establishing just what kind of financial and strategic fit LHi would be in Asia. LHi is based in Singapore but has production facilities in southern China. Under 3i's ownership LHi evolved from a business focused on patient monitoring into one offering sophisticated equipment like cables for surgical and video endoscopy applications.

According to Mr Liu, the acquisition offered Carlisle an opportunity to enter a business that complements its interconnected products division without competing with existing offerings. "There's a very good market globally for medical devices. It's a good fit," he says.

In a stroke of good timing, Mr Liu has been able to tap into recent treasury developments in Shanghai that will facilitate LHi's integration in Carlisle. In November 2014, Carlisle won approval from China's State Administration of Foreign Exchange to set up a US dollar cash pool in the Shanghai Free Trade Zone (Carlisle had already established an RMB cash pool two years before). As part of the integration of LHi, the company will be linked up to both the US dollar and RMB Shanghai cash pools, improving region-wide cash management. "We want the cash in this new entity monitored from China," says Mr Liu.

"There's no question that China is the hub."

IV. Finance: Striking while the iron is (still) hot

CFOs in 2015 face better options to finance growth than in any year since the financial crisis, with equity markets increasingly robust and debt markets still benign. But they must calibrate the balance between equity and debt carefully, as financial risk intensifies

CFOs' responses this year show a marked tilt toward weighting the balance sheet with equity, despite the availability of funding for growth via debt capital markets and traditional bank debt. More than half of the CFOs (53%) say that their companies are likely to increase their equity weighting on their balance sheet, a big jump from the 27% that said so last year. Responses were strongest in telecoms (63%), oil and gas (61%) and pharmaceuticals (59%; Figure 4.1).

Issuing shares now as prices are rising in markets across the region allows companies to lower equity-debt ratios ahead of a period when borrowing and servicing debt is expected to become more expensive. Deleveraging is a motive for capital structure change for more than one-third (41%) of the companies in the survey this year, compared to 15% last year (Figure 4.2).

Figure 4.1: Raising the (equity) stakes
% respondents considering raising equity weighting in capital structure
Change year-on-year in percentage points

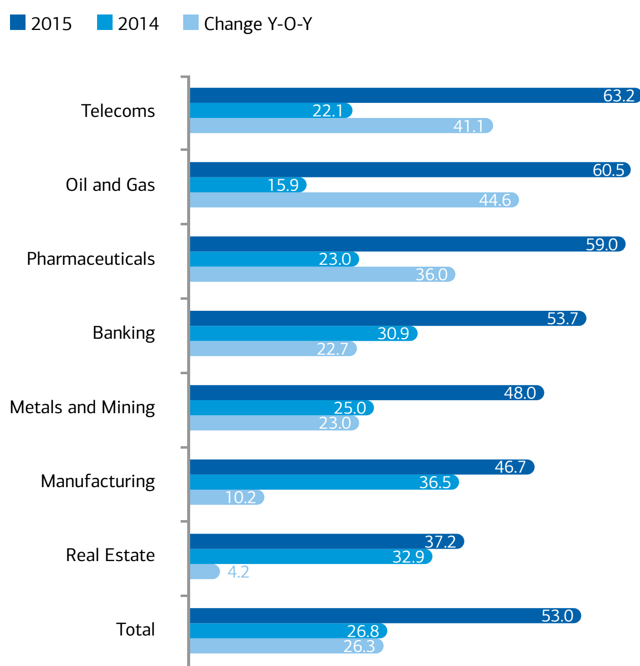
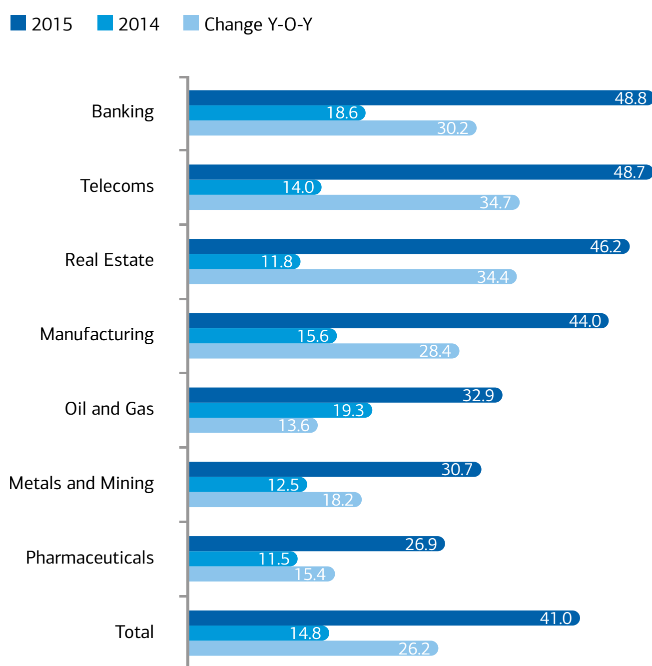


Figure 4.2: One hand on the lever
% respondents considering saying concerns over leverage are a reason for capital structure change
Change year-on-year in percentage points



Some of the enthusiasm for equity is a hold-over from the heady pace of 2014, a record year for Asian issuance. Total Asian proceeds from raising equity in 2014 amounted to US$220.4bn, up 41% from 2013 and the largest total since 2010, according to Thomson Reuters.[3] The biggest issuers came from high technology, financial and industrial companies. Moreover, four of the world's top five initial public offerings hailed from Asia last year, including the world's biggest ever: Alibaba's US$25bn IPO on the New York Stock Exchange.

[3]Thomson Reuters, Global Equity Capital Markets Review, Full Year 2014, January 2015. Available at http://dmi.thomsonreuters.com/Content/Files/4Q2014_Global_Equity_Capital_Markets_Review.pdf

Equity preferred...

Raising equity now is a good opportunity as stock markets reach their apogees. Japan's Nikkei share average was standing at a 15-year high at the time of writing in mid-March. Stocks on the Shanghai Exchange posted a seven-year high at the same time, while Hong Kong's Hang Seng Index and Singapore's Straits Times Index were near seven-year highs. Some exchanges cut a more volatile path than others (the FTSE Bursa Malaysia Kuala Lumpur Stock Index was trading lower than in March 2014, but still near a ten-year high), but the overall trend has been a solid climb.

"Our policy is to maintain an optimal capital structure, keeping the financial risks manageable on the one hand, and not making the balance sheet lazy on the other," says Sanjay Ahuja, CFO of Bangkok-based Indorama Ventures. The materials firm, one of the world's largest makers of polyester, is listed on the Thai Stock Exchange. He adds, "I would say that in adjusting the weighting on the balance sheet toward equity, I have been very proactive." (See also the case study, on page 48.)

Energy price volatility is only one factor creating uncertain in equity markets, which include concerns over the impact of higher interest rates on Asian corporates with high leverage. While prospects vary from market to market, the motive underlying the enthusiasm for equity is similar in most cases. CFOs from Japan (64%) were ranked fourth among the respondents that favored increasing equity weighting on the balance sheet, after Thailand (70%), Taiwan (70%), and Indonesia (66%). CFOs from the same four countries held the top position when asked whether they planned to change balance sheet structure to address excess leverage, with Japan in the lead (52%) followed by 50% of the respondents from each of Thailand, Indonesia and Taiwan.

"Our policy is to maintain an optimal capital structure, keeping the financial risks manageable on the one hand, and not making the balance sheet lazy on the other." Sanjay Ahuja, CFO, Indorama Ventures

Follow-on enthusiasm from last year's hot stock market is still evidence, as well. Japan had a strong 2015 start in IPOs. The market anticipates the possible listing of Japan Post Holdings, which owns the nation's postal service, the country's biggest bank and a major insurer. The issue—if it finally unfolds—would likely exceed Alibaba's. In Taiwan, electronics and tech manufacturers, which make up a major component the listed shares, are enjoying a revival of demand from the US market. Investor optimism is keeping the market buoyant.

...but debt is still attractive—for now

If and when Asia's stock markets contract, it will be in response to concerns over leverage. Debt issuance in US dollars, euros, and yen in Asia set a new record in 2014, reaching US$210.1bn from 371 deals, according to Thomson Reuters, exceeding 2013's record-setting US$142.8bn. China was in the lead, with issues from Alibaba Group and Bank of China in the fourth quarter accounting for US$14.5bn. Issuance in the local currency bond market by contrast slowed to US$457bn, down about 3% from a record high in 2013. Issuances in renminbi from China accounted for 54% of this total, followed by bonds denominated in Korean won and Indian rupees. The offshore renminbi market had a strong year, reaching a record high of Rmb330.6bn in 599 deals.[4]

The leverage building among Asian corporates has become an increasing concern for investors. The failure in January 2015 of China real estate developer Kaisa to meet a US$23m interest payment on its US dollar denominated bonds alerted investors to the risks. Rating agency Moody's reports that the trailing 12-month high-yield default rate for non-financial companies in Asia equalled 3.9% of outstanding issuance in 2014, up from 2.2% in 2013. In contrast, the same figure for the US and Europe trended downward to 1.9% and 1.8%, respectively.[5] Yet conditions that favour low-cost borrowing still persist. As mentioned above, Asian central bankers are expected to keep rates low in 2015, "decoupling" monetary policy even as US dollar bond markets reflect the impact of a rates tightening later this year.

[4]Thomson Reuters, Global Debt Capital Markets Review, Full Year 2014, available at http://dmi.thomsonreuters.com/Content/Files/4Q2014_Global_Debt_Capital_Markets_Review.pdf
[5]Moody's, Asian corporate high-yield default rate to stay low in 2015, 11 March, 2015. Available at http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_1002613

Amid these crosscurrents the borrowing needs of Asia's CFOs are increasing. Sixty-two percent of CFOs say their borrowing needs will increase in 2015, or double the number of respondents (31%) who said so in 2014 (Figure 4.3). The strongest 2015 responses hail from oil and gas (72%), manufacturing (72%) and telecoms (67%). Manufacturing companies and telecoms are eager to build on gains in established markets. For oil and gas companies, borrowing needs have grown as the firms seek stability in an environment of lower energy prices.

"Good companies can get any amount [of funding] they want in any market. But where will this all end up in a few years? For the first time since the 1930s, people are worrying about global deflation."

Henry Lin, CFO, Wistron

Despite the attractions of tapping the equity market in his country, Henry Lin, Taiwan-based CFO of Wistron, an original design manufacturer that was a spin-off from Acer in 2000, sees bank debt as the obvious preferred funding avenue for now. "It's still much cheaper to service debt than equity," he says. And in Taiwan's crowded banking market, it is not currently tough to find competitive rates and willing bankers.

From a broader perspective, however, Mr Lin is concerned over mounting leverage in the global system. "Many countries have adopted quantitative easing. Every country is copying the model. Good companies can get any amount [of funding] they want in any market. But where will this all end up in a few years? For the first time since the 1930s, people are worrying about global deflation."

Figure 4.3: Going to the well, again

Outlook for borrowing needs compared to previous year

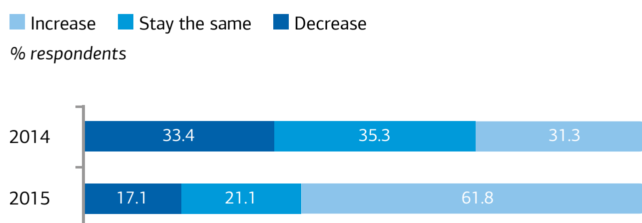
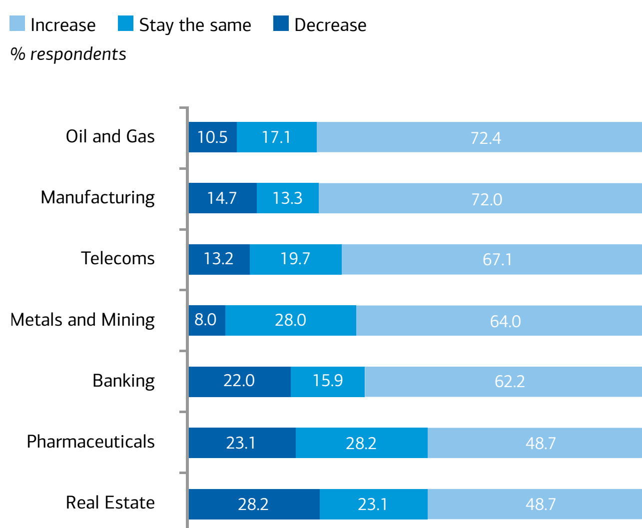


Figure 4.4: Buddy, can you spare a dime?

Outlook for borrowing needs in 2015 compared to 2014



Bank loans remain the most preferred avenue of funding in Asia, as last year (Figure 4.5). The result, however, reflects more a confidence that affordable funding will still be obtainable in 2015—given the uniform moves by Asian central banks to lower rates—and in the stability of their banking relationships than in current borrowing activity. Bankers report that new originations have subsided from previous-year levels as CFOs pursue available opportunities in equity and bond markets. Issuing debt is also attractive to CFOs in the region—for now—with international and local-currency bonds higher in the ranks of preferred funding sources this year than in 2014 (though still below equity). When considering long term debt in either category, CFOs are eying both to lock in funding at lower rates before an expected US Fed interest rate hike and while rates remain low in local markets in Asia.

Figure 4.5: Bank raid

What type of financing does your company plan to use this year? Rank among options listed, all countries

Rank	2015	2014
1	Bank loans	Bank loans
2	Cash flow financing	Internal sources or self-funding
3	Equity	Syndicated loans
4	Asset-based financing	Equity
5	Commercial paper	Asset-based financing
6	International currency bonds	Cash flow financing
7	Internal sources or self-funding	Commercial paper
8	Disposal of assets	Leasing
9	Local currency bonds	Disposal of assets
10	Securitisation	International currency bonds
11	Leasing	Local currency bonds
12	Syndicated loans	Securitisation

Heading off headwinds

In some cases, companies are diversifying their risk by choosing all funding options, before headwinds develop. Ayala Group, the oldest conglomerate in the Philippines, said in February that it has allotted Peso185bn (US$4.1bn) in capex for 2015. The diversified company has plans to pour funds into Ayala Land, Globe Telecom, Manila Water Co, the Bank of the Philippines Islands, and Integrated Micro Electronics, an original design electronics manufacturer. Ayala Corp has met some of this financing need by raising US$1.3bn in 2014 through an issuance of exchangeable bonds, reissuance of preferred shares, loan drawdowns and an equity placement. The parent company's consolidated net debt to equity ratio remains at 0.85. The group's cash position is strong with P48.3 ($1.1bn) in cash and cash equivalents (see the case study on page 28).

As with Ayala, the driver of capital structure change across Asia is growth. Two thirds (63%) of the CFOs say that financing growth and capital expenditure is the reason they are likely to change their capital structure this year, up from 35% in 2014. Likewise, when asked for what purpose CFOs are currently considering financing, almost half (48%) named expansion within countries of operation, while 40% cited growth into new markets. In contrast, financing for acquisitions was named as a reason by 26% of the CFOs. Companies' drive to expand organically is still paramount in a year when growth is still expected to be strong across the region, despite rising financial risks.

In a growth environment, using cash flow wherever possible to fund capex is still a desired route for CFOs. Catherine Yu, Herbalife's Hong Kong-based regional controller for Asia Pacific & China, says that her company is using cash flow to fund a new production facility in Nanjing. CFO Pratibha Advani of India's NIIT says that it is using cash to fund expansion on several projects, including building a second phase of its Noida campus.

Cash in hand

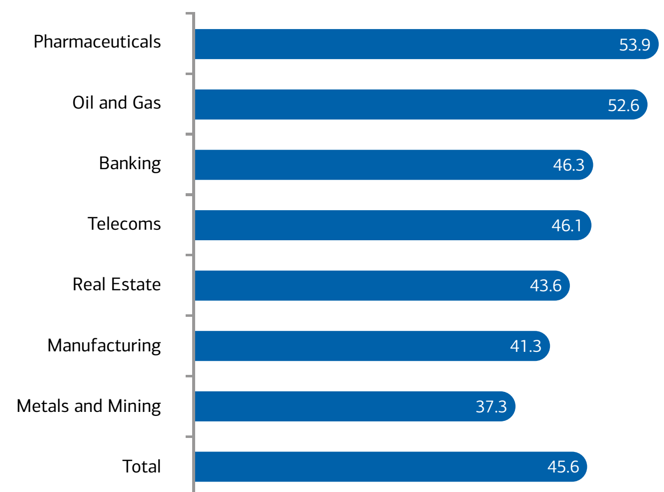
Meanwhile cash flow financing—a practice in which a bank lends funds, generally for working capital, using the expected cash flows that a borrowing company generates as collateral—is on the rise. Forty-six percent of CFOs say they plan to use this type of financing this year, up from 18% last year, making it the second-ranked source of financing. CFOs from pharmaceutical companies (54%) and oil and gas firms (53%) were the most likely to pick this as a means of financing (Figure 4.6).

Both industries are facing funding gaps due to structural changes. The oil and gas industry is amid grappling with the lower price of crude oil, with the shutdown of some production and exploration until prices rebound. As direct financing from operating cash flows—a traditional method of mid-tier to large oil firms—has become more difficult, cash flow financing has emerged as a solution supported by long-term banking relationships. The pharmaceutical industry, undergoing a long-term structural change, faces rising R&D costs, higher risk in introducing new drugs and greater pressure from shareholders to return cash—as well as a hangover from a wave of debt-financed M&A in recent months. The environment has made cash flow financing a more attractive option.

Every prudent option is open for CFOs in Asia just now. CFOs are embracing them all, but with the knowledge it won't be too long before a new, more volatile phase, begins.

Figure 4.6: Cash-flow credit

% respondents considering using cash-flow financing in 2015



Case study

Sung Hwan Choi, The Export-Import Bank of Korea: Volatility has its uses

Increasing market risk has made the high-grade international bonds, including Kexim paper, one of the best performing asset classes, says Kexim's CFO

The Export-Import Bank of Korea, or Kexim, has long enjoyed the status of being one of the biggest offshore bond issuers in Asia, a role that ensures the risk appetite of the export credit agency stays finely calibrated to changing market conditions. So when Kexim announced in December 2014 that it would raise US$13bn in international capital markets in 2015 (the same as the 2014 total), the plan to diversify was a continuation of a well-established strategy.

"Diversification of funding sources is one of our key funding strategies to secure stable market access and to prepare for any potential disruption in the dollar market," Kexim CFO and executive director Sung Hwan Choi said. A dramatic increase in amounts that Kexim has been funding—the figure has doubled over seven years—"motivates us to tap non-US dollar markets, as the US dollar market alone cannot accommodate more than US$10bn of our annual funding target. Cost effectiveness and investor-base diversification are also concerns."

"The Fed's words and actions will create volatility as we head further down the year, but I believe the manner in which the hike is communicated will dictate how the market will react." Sung Hwan Choi, CFO

Mr Choi said that this year, the policy bank will divide its international fund-raising needs between public bond markets and private placements or bank borrowing. The emphasis will be on bonds, as they provide a safe haven in an increasingly volatile market. "Recent shocks such as oil price volatility, geopolitical risks and rates volatility have stunned the market, but it has also reacted quite rationally and in an orderly fashion." He also said that volatility has had the residual effect of making the bond market, especially the high-grade market, one of the best performing asset classes.

"Interest rate volatility can be a different matter," he warned, but here he too he has confidence in markets' ability to absorb any move by the US Federal Reserve. "The Fed's words and actions will create volatility as we head further down the year, but I believe the manner in which the hike is communicated will dictate how the market will react." Efforts by the Eurozone, Japan and China to "churn out fresh money" may mitigate some of the risk, but "whether it will offset a liquidity squeeze by the Fed, and fulfill a 'happy handover' scenario, is yet questionable."

As the year progresses, Mr Choi sees currency volatility risk on the rise, as countries fend off deflation by devaluing their currencies. "More than 20 countries including the Eurozone, China, Japan and Korea are joining the currency wars by accommodating easing monetary policy and devaluing their own currencies. Such moves will continue to amplify currency volatility." He anticipates that changes in the value of China's currency will play a major role in the currency wars, "as Beijing is itching to further devalue CNY through another round of rate cuts to address slowing growth and the weakening Euro."

Mr Choi anticipates that the RMB market will continue its growth momentum. "We have been a longstanding issuer in the offshore RMB bond market since 2010 and we always monitor the market for potential issuance opportunities."

The enthusiasm does come with some caveats. “It cannot be denied that the offshore RMB market is still considered an opportunistic market,” Mr Choi said. This is especially true for international issuers looking to swap the proceeds back to their original currencies. “The current offshore RMB market is unstable and hugely depends on the swap market conditions. This is a significant obstacle that the offshore market needs to overcome in order to become a truly benchmark funding market.” One element supporting such a change is the year-on-year increase in RMB trade settlements.

The finely attuned awareness of risk is an essential qualification for Mr Choi’s job. With about 90% of Korea’s GDP accounted for by the nation’s export and import sector, according to Mr Choi, “Kexim’s role and function are critical for the sustainable growth in the nation.”

Moreover, the policy bank’s clout is growing. As of January 2015, the Korea Development Bank merged with the Korea Finance Corporation. Kexim absorbed the overseas assets of the latter as a result. To support Korean export businesses Kexim expects to extend about US$73bn in credit in 2015, with two thirds in loans and one third in guarantees.

“Kexim’s role will only strengthen in the market going forward,” Mr Choi said. So too will Kexim’s vigilance of a changing market. “We live in a globally connected world where changes are fast and impactful—yes I expect volatility to continue.”

Case study

Sanjay Ahuja, Indorama Ventures: Timing is everything

Indorama Ventures took the innovative approach in the way it raised equity ahead of expected market volatility

CFO Sanjay Ahuja has had to master the art of planning ahead to fund capex in his business, Indorama Ventures, a Thailand-based maker of intermediate products that end up as polyester. The business, like many in the petrochemical industry, is in a crowded market that is hobbled by overcapacity. Yet Indorama, listed on the Thai stock exchange and with US$7.9bn in annual sales in 2014, is one of the world's largest players: it has 15% market share in a core resin that contributes to ubiquitous polyester. Because of its size, it has more leeway than many of its competitors.

"There are a lot of smaller players that aren't seeing profitability, because they don't have scale," says Mr Ahuja. These players are getting weaker, and becoming acquisition prospects. "We decided that the best way for us to grow was not to add to capacity but to increase our market share through buyouts."

"The growth projects could have been done with our strong internal cash flows, as well as raising a straight senior debt for the shortfall. However, the board of directors and the senior management were committed to the idea of increasing the weighting of equity on the balance sheet." Sanjay Ahuja, CFO

In an expansion plan vetted by shareholders, Indorama laid out a scheme to achieve four acquisitions and two "brownfield" projects—or redevelopment of existing facilities—in 2014 and 2015. Looking beyond this, Indorama is amid the internal approval process for major greenfield projects to produce upstream feedstock for its core products. These would begin construction in 2017 and start operations in 2019.

Meanwhile, the company is debt averse. Its ratio of net debt to equity stands at 0.8 to 1, well below a level considered unsustainable by ratings agencies (as a rule of around 1.5 to 1) and its bankers' loan covenant threshold of 2 to 1.

"The growth projects could have been done with our strong internal cash flows," says Mr Ahuja, "as well as raising a straight senior debt for the shortfall. However, the board of directors and the senior management were committed to the idea of increasing the weighting of equity on the balance sheet."

Mr Ahuja's strategy was two-fold. As a preliminary funding move for the greenfield projects, in July 2014 the company issued free warrants to all shareholders that would increase—once exercised—equity capital by Baht33bn (US$1.1bn).

"These projects require substantial outflow of funds over a period of 2-3 years when they are built," Mr Ahuja explains. "The exercise price is higher than the current market price, and we expect the warrants to be exercised in 2016-2018" or in the period when the capital would be needed for the projects.

The warrants—a series of two issued to each holder of stock for free—present an interesting proposition to shareholders. The funding only works for Indorama and its shareholders if a) Indorama's share price rises to the strike prices set for the two series of warrants (both at a level well above the trading price at the time of writing), and b) if shareholders decide to exercise them—thereby agreeing that the value of the projects outweighs any subsequent dilution of their existing holdings.

In effect, Indorama is asking shareholders to shoulder some of the risk of the projects, while also offering a greater share of the upside when the expansion comes on line and adds to profitability. So far, shareholders have seemed positive. Indorama's stock price rose after the warrant issue, although it has since become more volatile as oil prices began an accelerating decline in August.

The second capital raising was equally distinctive. To fund its immediate acquisition plans, Indorama issued Baht15bn (US$461m) in perpetual bonds at the end of October 2014. The largest such bond issuance ever in Thailand, the fresh capital added to equity, as this variety of bond—which has no maturity date and can be redeemed at any time—has equity-like characteristics and can be accounted for under International Financial Reporting Standards as equity.

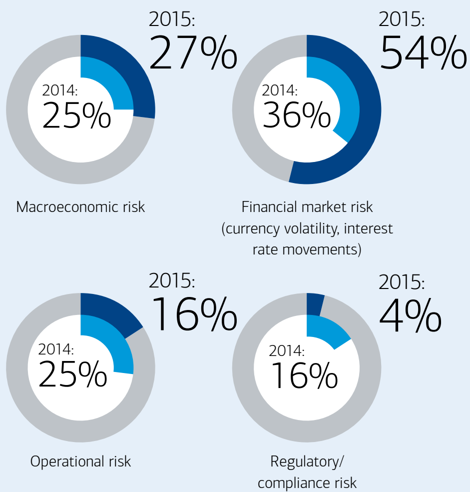
The funding strategy has "improved our leverage ratio has allowed us to pursue attractive growth," Mr Ahuja says.

V. Risk: Welcome to a more volatile world

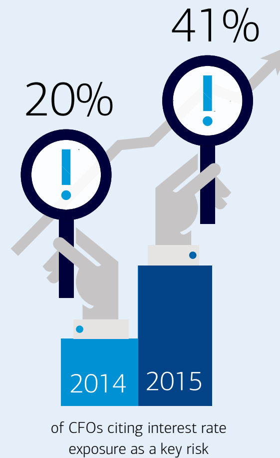
The world is riskier, and Asia's CFOs are more concerned—but also confident in their ability to manage the turbulence

Financial risk takes centre stage

Main risk concern in the coming year

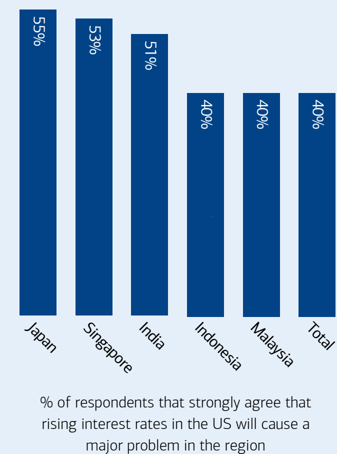


Concerns over interest rate risk have risen since 2014...



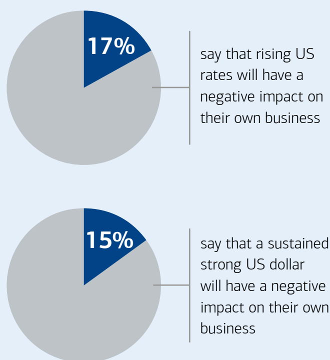
of CFOs citing interest rate exposure as a key risk

...with fears that rising US rates will hit Asian markets

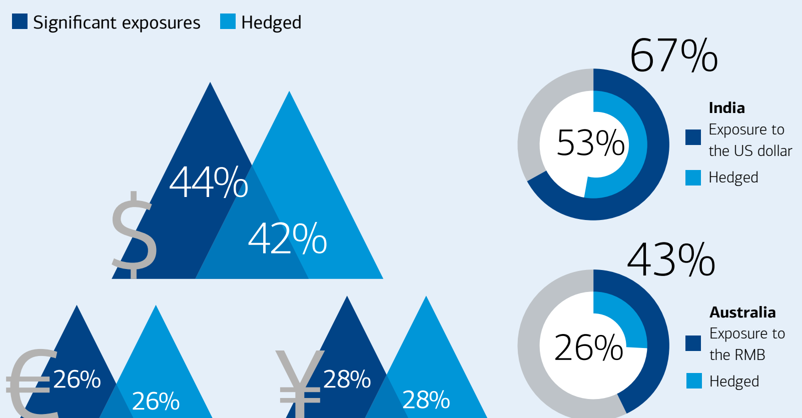


% of respondents that strongly agree that rising interest rates in the US will cause a major problem in the region

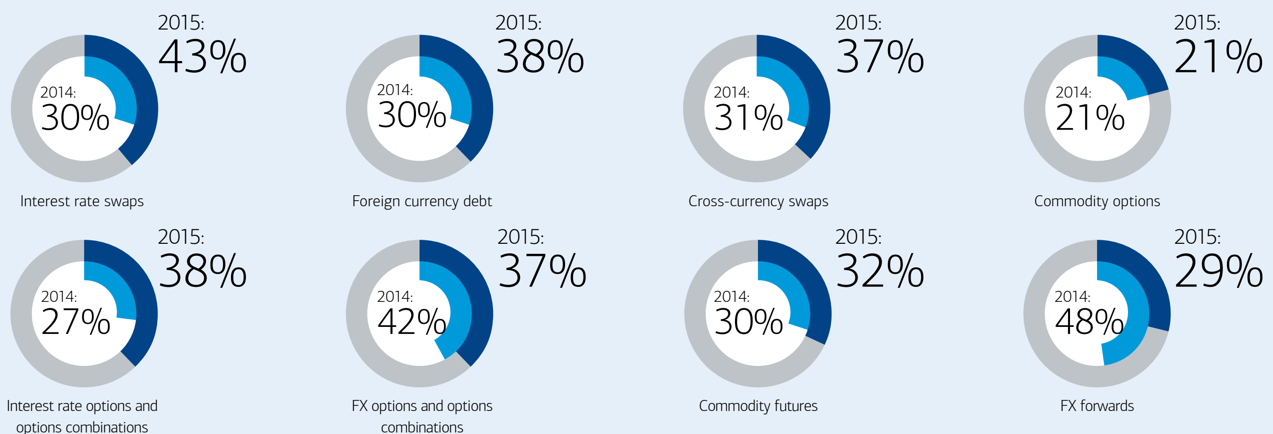
But CFOs are confident in their own strategies and unconcerned about US dollar strength...



Key currency exposures are mostly hedged but hedging gaps are opening



Hedging interest rate exposure dominates the choice of instruments...



“The CFO’s role to push more discipline into each process of company operations to optimise cash return becomes especially important in a volatile period like this,” says Michelle Liu, CFO for Greater China of Lanxess, a chemicals firm based in Germany.

CFOs in Asia have been anticipating greater market volatility and tougher financing conditions ahead of a possible rise in US interest rates, while sharp currency movements—as central banks across Asia have cut their own policy rates in response to softening growth in the region—have added uncertainty to balance sheet management. More than half (54%) cite financial market risk as their single greatest concern this year, up from 36% in 2014 (Figure 5.1).

“The CFO’s role to push more discipline into each process of company operations to optimise cash return becomes especially important in a volatile period like this.”

Michelle Liu CFO, Greater China, Lanxess

Furthermore, a big majority (86%) of CFOs agree or strongly agree that rising interest rates in the US will cause major problems in Asia, with those in Japan, Singapore and India the most pessimistic (in each case majorities strongly agree, Figure 5.2). Overall, 41% of CFOs name interest rate movements in general as their foremost financial risk concern in the year ahead. The level of concern varies from different parts of the region: a substantial majority (80%) of CFOs in Singapore, 60% of those in the Philippines and 56% of those from Japan cited interest rate movements as their biggest financial risk concern, compared to 16%, 17% and 21%, respectively, in the 2014 CFO Outlook Asia report (Figure 5.3).

Figure 5.1: Watch carefully...

% respondents citing financial market risk as greatest concern in coming year; change year-on-year in percentage points

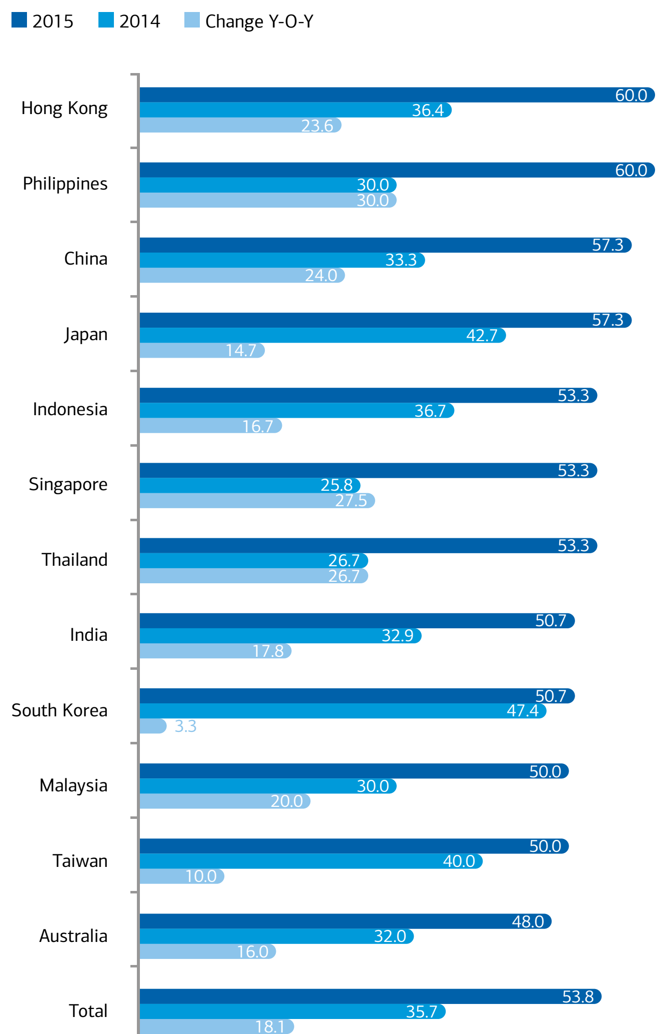
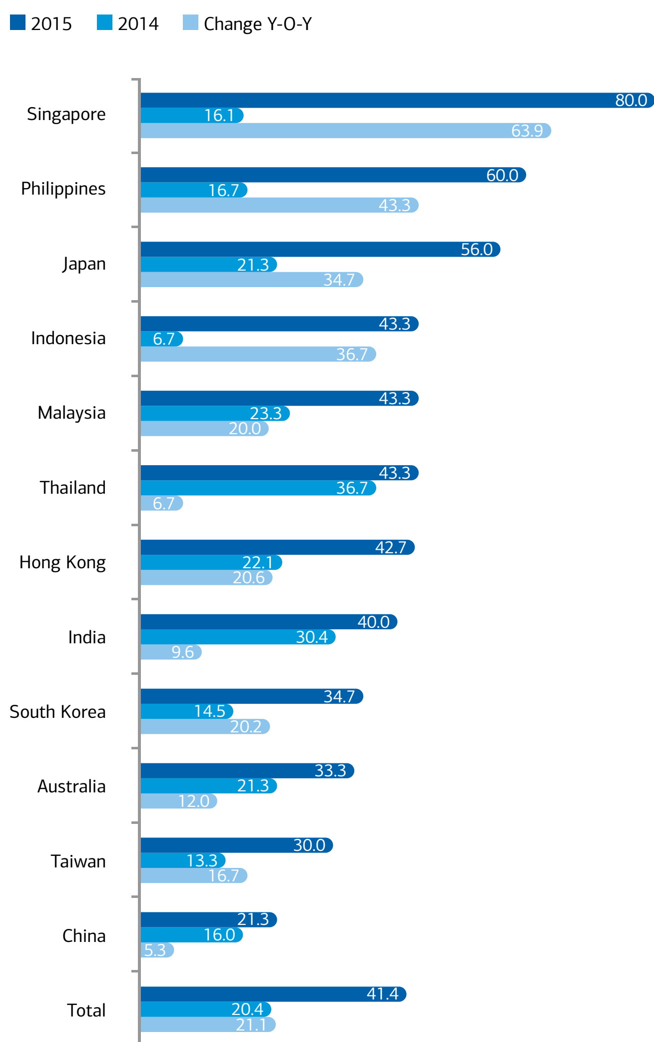


Figure 5.2: Storm on the horizon?
"Rising interest rates in the US will cause major problems in Asia"
% respondents strongly agreeing

Figure 5.3: A ratings concern
% respondents citing interest rate movements as greatest financial concern in year ahead



Over-exposed?

The concern in Singapore is related to the degree of leverage taken on by companies there during the sustained period of low rates, a phenomenon pronounced enough to elicit a warning from Monetary Authority of Singapore in November 2014. "Highly leveraged companies, especially those with low net profit margins, may find the increase in borrowing costs eroding their cash flows," it advised.[6]

In the Philippines, a sustained period of economic stability under the administration of Benigno Aquino III, and an increasingly competitive banking sector, has led to accelerated borrowing in recent years. Meanwhile, the Philippines peso has declined sharply against the US dollar for the past year (although it stabilised in the first quarter of 2015).

In Japan, company exposure to US dollar funding and repayment risk has increased as the yen continues to weaken. In early March 2015, the yen continued its retreat against the US dollar and the euro after the government revealed GDP had grown just 1.5% in the final quarter of 2014, short of its initial 2.2% estimate.

By contrast, far fewer CFOs in China (21% in 2015, up slightly from 16% in 2014) cite interest rate changes as a primary concern. Monetary policy is tightly controlled by China's central government, and companies have a measure of confidence in the ability of policymakers to insure against sharp movements.

"China's GDP growth may be slowing, but it's still growing at 7%."

Bruno Li, CFO, Trinity

To be sure, many companies in China have US dollar exposure, a factor that was strengthened last year as companies began to lock in low interest rates ahead of any US Fed action, and which reached its peak with Alibaba's whopping US$8bn dollar-denominated bond offering in November 2014. But even for those companies with substantial exposure to US dollar debt, China's management of the exchange rate softens borrowers' risk in repayment of interest and principal. What is certain, though, is more two-way currency volatility as China takes continued steps to liberalise the RMB.

[6] "Debt-ridden Singapore firms at risk as interest rates rise", Singapore Business Review, November 4th 2014

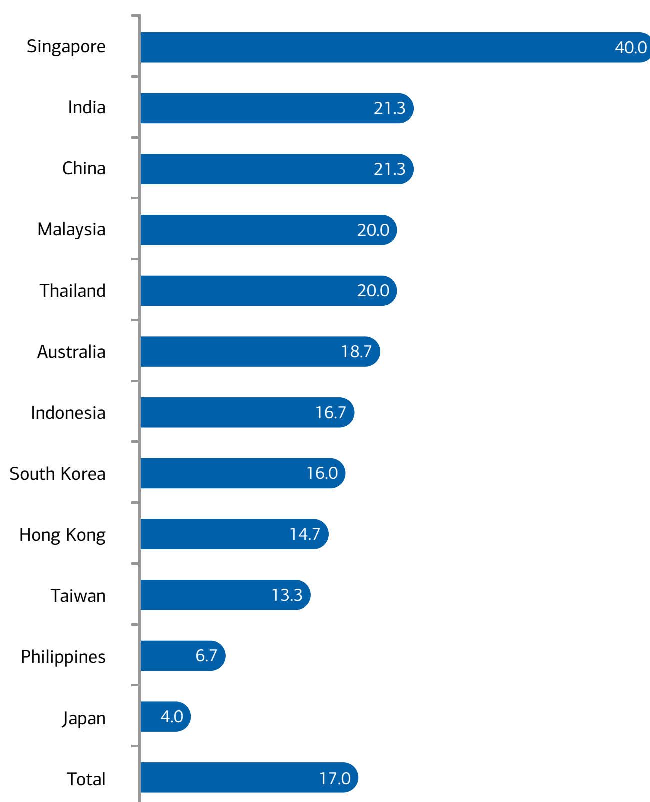
Another factor is the high number of companies that fund operations with cash flow in China. Their degree of leverage is limited. “China’s GDP growth may be slowing,” says Bruno Li, CFO of Li & Fung-owned retailer Trinity, “but it’s still growing at 7%.” Mr Li says Trinity has zero leverage in the country, financing all operations by cash flow.

Likewise, US health and vitamin retailer Herbalife finances its China operations and capex with cash flow. “Our model is cash on delivery,” says Hong Kong based regional controller Catherine Yu. “So we have a lot of available cash, and can use it to expand without taking on leverage and the risk that comes with it.”

And, it turns out, the prospect of rising interest rates can be regarded as a positive—as a reflection of growth. Only 17% of CFOs believe that rising US interest rates will have a negative impact on their own businesses (Figure 5.4). Whether this is hubristic overconfidence time will tell, but the result is in keeping with the US economy’s robust return to health, and recognises that interest rates are a natural complement to a growth economy. Better US prospects are helping to improve many Asian companies’ export sales. Others, like India pharma giant Dr Reddy’s, see the US as their greatest potential growth market in 2015. “That’s where we will be focusing this year,” says Saumen Chakraborty, CFO of the Hyderabad-based company (see the case study on page 62).

Figure 5.4: No worries, mate?

% respondents saying rising interest rates in the US would have a negative impact on their own business



Wary on the home front

Looking overseas has become not only opportunistic, but a hedge against the possibility of slowing growth at home. The situation within the region looks considerably more challenging, and policymakers across a range of countries have responded by easing monetary policy: in chronological order India, Singapore, Australia, China, Indonesia, South Korea and Thailand have all cut policy interest rates in 2015 (or, in Singapore's case, adjusted the currency trading band), in some cases more than once.

Concerns about slowing growth and falling prices are at the root of the policy easing. The fall in energy prices has added deflationary pressure, which has been exacerbated by weak demand in key markets. "Factory gate" prices have been declining in China, South Korea, the Philippines, Taiwan and Singapore for months. To illustrate the volatility of the situation, China reported a mild rebound in inflation in February, yet its producer price index fell by 4.8% year on year, its sharpest decline since October 2009. If prices drop for too long, companies cut investment and lower employees' pay, adding to the downward pressure on prices and further slowing growth. Deflation worries prompted the People's Bank of China to lower benchmark interest rates by 25 basis points in March, its second cut in three months.

CFOs are as wary as their central bankers. In Thailand, 67% of CFOs named slowing growth in their home economy as their biggest macro risk concern, followed by Singapore (63%), Indonesia (43%), and China (43%). The responses last year were much lower, at 33%, 26%, 27%, and 17%, respectively (Figure 5.5). In Indonesia, falling commodity prices and a drop in investment have slowed growth. Thailand's economy entered deflation in February 2015 for the first time since 2009, with a contraction in the consumer price index accelerated by falling oil prices. The response from Singapore reflects deflationary fears, but also the prospect of rising costs as a weakening currency against the US dollar exposes businesses in major local industries with US dollar payables, such as shipping, logistics and port terminal operations.

The proportion of CFOs in China concerned over a slowing economy there more than doubled from last year's survey, reflecting the sharp rise in concern over Asia's biggest market for many companies. The government has announced a new, lower GDP growth target of 7% for 2015—down from 7.5% last year—while businesses have also had to contend with the uncertainties of an ongoing anti-corruption campaign that has ensnared many high-profile figures. (For more on multinationals' plans in China, see section II.)

Figure 5.5: Home is where the hurt is
% respondents citing slowing growth in home market as greatest macroeconomic concern in year ahead

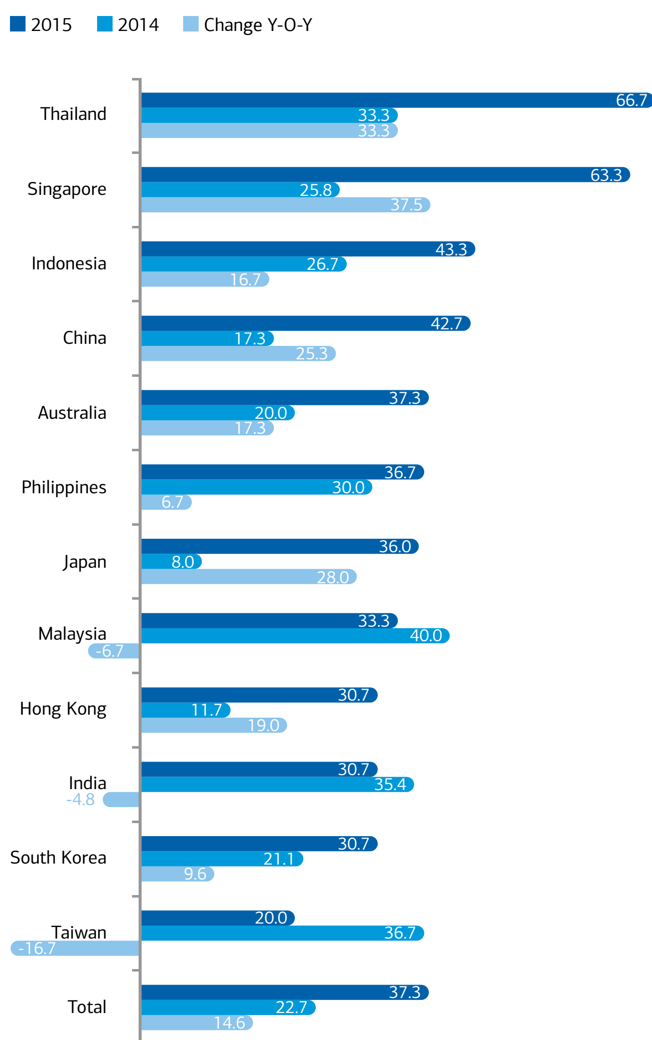
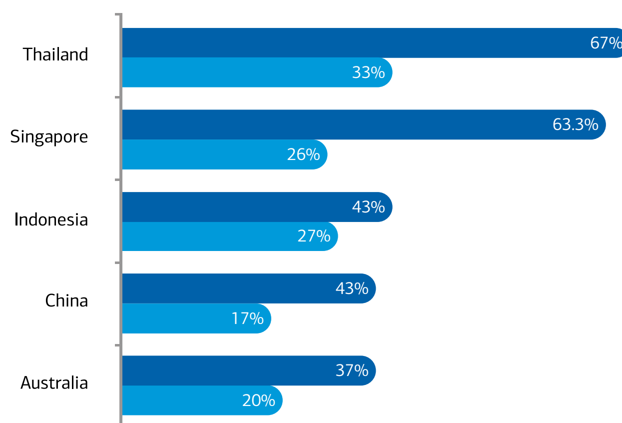


Figure 5.6: Concern over slowing growth in home markets accelerates
% respondents citing slowing growth in home market as greatest macroeconomic concern in year ahead



Meanwhile, slowing growth in overseas markets is named as a key concern by CFOs in Japan (49%), Hong Kong (45%) and South Korea (43%), reflecting persistent economic malaise in Europe as well as China's outlook of slowing growth (figure 5.6). The strong US dollar has helped revive demand in these highly export-driven economies, yet they remain vulnerable to weakness in other trading partners. Overall, 37% of the CFOs name slowing growth overseas as a key concern in 2015, slightly up from the 33% who said so last year.

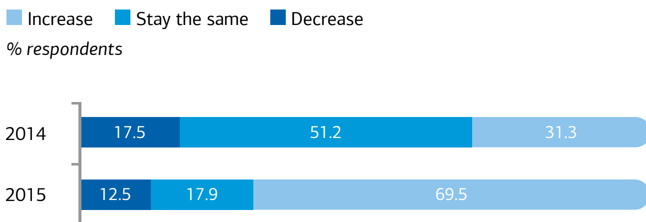
Belt and braces

The divergent paths of US and Asian monetary policy means currency volatility is likely to intensify. CFOs' focus on hedging against interest rate and currency movements has become all the more important as a result.

Some 41% of Asia's CFOs say they are hedged against interest rate exposures, up from 23% in 2014. Malaysian companies have been more aggressive hedgers than their Asian peers. About two thirds (63%) of CFOs from Malaysia say they are hedged against interest rate movements, up from 37% last year. The figure reflects the pressures on Malaysia's energy sector, comprising roughly 15% of GDP. Malaysian dollar bonds are the only notes issued in Asia so far this year (at the time of writing) to have declined in price in secondary market trading, reflecting investors' concern over issuers' ability to service outstanding debt. In this strained environment, the protection offered to cash flows by interest rate swaps delivers a measure of security to struggling corporate borrowers.

Rising interest rates in the US—and Asia, eventually, once the current easing cycle ends—imply higher capital costs ahead. In keeping with concerns over interest rates, a substantial majority of Asian CFOs see their capital costs rising this year, with 70% saying their cost of capital will go up, compared to 31% last year. Only 18% see the cost of capital staying the same as in 2014, whereas about half (51%) of the CFOs responding last year said it would stay the same as the year before (Figure 5.7).

Figure 5.7: Getting pricier
Over the next year, the cost of capital will...



In such an environment, obtaining money for growth and working capital before pricing climbs can be regarded as a matter of risk management, or at the very least, prudence. Alibaba's November bond issue was designed to lock in interest rates at historic lows. The US$8bn issuance came to market in six tranches, with maturities that included five, seven, 10 and 20 years as well as a three-year fixed rate bond and a three-year floater. Malaysia's oil giant Petronas took a similar step with its US$5bn US dollar bond issue on March 11th 2015, the largest from Asia since Alibaba. The issuance included 30-, 10- and seven-year maturities and a five-year US dollar sukuk, or Islamic bond. Both issues were locking in gains at varying maturities taking advantage of the market's sweet spot as a hedge against probably rising funding costs.

Dollar blues

Similarly, exposures to adverse shifts in foreign exchange rates have climbed, but CFOs are covering the risk: 46% say they are hedged against expected forex movements, compared to 41% last year. And 44% of the respondents say they have significant exposure to the US dollar, while 42% say they are hedged against adverse movements in the currency, both significantly up on 2014.

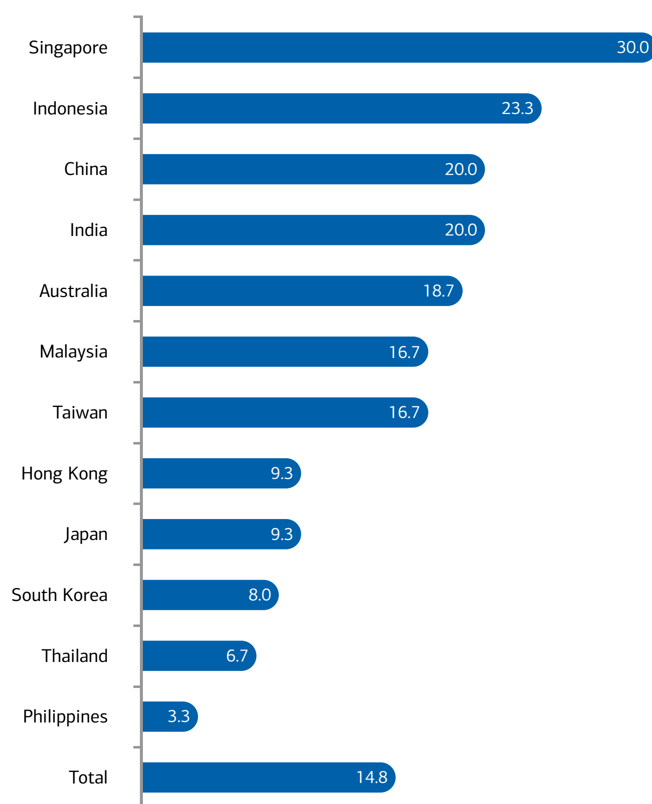
More hedging protection explains the relatively limited proportion (15%) of CFOs that cited a strong dollar impact as negative, with concerns highest in Singapore (30%), Indonesia (24%), and India/China (20%), nations where a fast appreciation in US dollar value has disrupted local economies before (Figure 5.8).

Even companies that are feeling the pain have taken steps that add reassurance. The majority of Herbalife's sales are overseas in currencies other than the US dollar. Exposure to currency headwinds was the main reason that Herbalife's fourth quarter profits declined 16% year-on-year, while revenues were down 11%. Interestingly, China, where Ms Yu says profits grew 19% in the fourth quarter, was the best-performing market for the company. Herbalife is reinvesting much of its cash proceeds into growth and operations in China, making profits there less vulnerable to volatility like last year's sudden depreciation in the yuan.

Herbalife has bolstered its hedging in response to what it believes will be a protracted period of volatility ahead. According to Ms Yu, the company has a dedicated corporate treasury team that closely works with banks on the execution of hedging strategies, with the goal of mitigating the inevitable headwinds of currency exposure.

Figure 5.8: Strong-dollar sanguinity

% respondents saying a sustained strong US dollar would have a negative impact on their own business



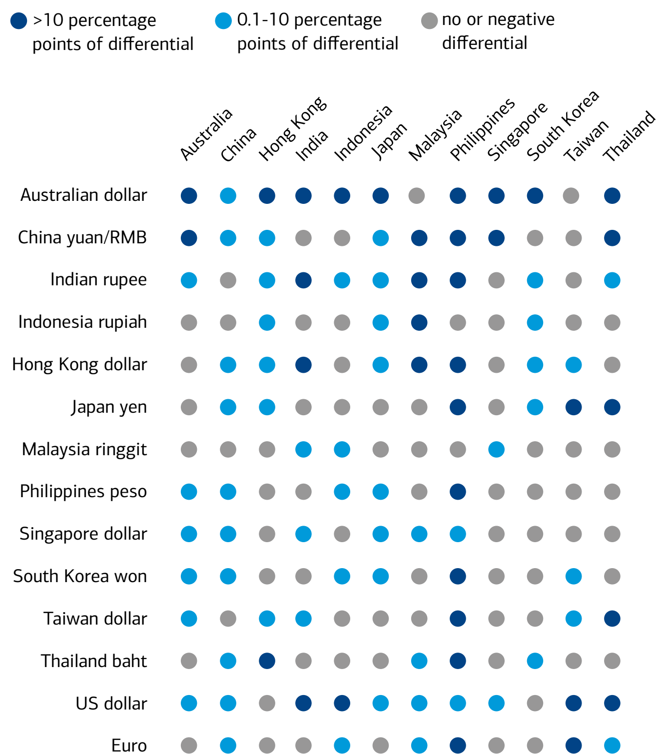
CFOs' responses indicate that moves in other currencies are mostly covered, but Australia and India are exceptions. About half (47%) of Australian respondents say their company has large A$ exposure, but only 28% say they have hedged against adverse movements in their home currency (Figure 5.9). The result likely reflects the general view that the Australian dollar will remain weak this year. The nation's economy is strongly linked to exports of minerals and raw commodities, particularly to China, in an era in which commodity prices are projected to continue falling.

Moreover, 43% of Australian respondents say they have significant exposure to the renminbi, which is to be expected as China is the main buyer of Australian exports of iron ore, coal and other commodities. Yet only 26% say they are hedged against movements in the currency.

In India, two thirds (67%) of CFOs say that their companies have significant exposure to the US dollar, while only 53% say they are hedged against adverse movements in the currency, a surprising result given the rupee's recent volatility. The currency's decline against the US dollar accelerated in March following stronger-than-expected US employment figures. Indian CFOs are also likely to have a visceral memory of the rupee's sharp drop in 2011, leading to widespread fears of payment default on US dollar borrowings. This makes their greater propensity to eschew hedging all the more surprising. Dr Reddy's Mr Chakraborty—who hedges virtually all of the pharma company's currency exposures—chalks this up to the fact that relatively few Indian companies have expanded outside the domestic market, a pattern he expects to change if the Modi reforms take hold.

Figure 5.9: Forex hedging dashboard

Differential between % respondents reporting significant exposure and % saying they are hedged in that currency



Rainy-day cash

CFOs in Asia are also returning to the tried-and-true method of building cash reserves for a rainy day. Following the Asian currency crisis of 1997, when even healthy companies found themselves highly exposed to repayment risk in US dollars, it became a common practice in South-east Asia and India to build cash buffers rather than return cash to shareholders, while Japanese and South Korean companies have always tended to retain cash for reserves. The practice is making a return performance, region-wide. Almost three quarters (72%) of CFOs say they will deploy surplus cash by building cash reserves, up from 28% last year (Figure 5.10).

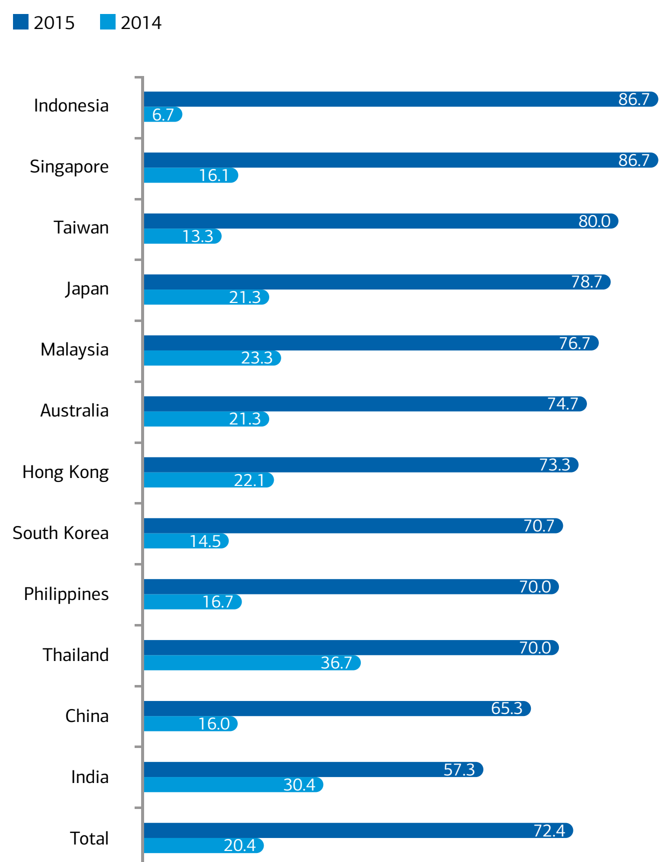
And awareness of the most basic risk of all—physical harm to employees and operations—has suddenly gained more attention this year. Some 24% of CFOs in the survey cite natural disasters and incidents that lead to declaration of force majeure as a key operational risk in 2015, compared to 12% the year before.

The CFO of Singapore-based International SOS, Nigel Pool, sees the heightened awareness of "acts of God" as an outgrowth of a developing global corporate trend. International SOS provides medical, travel and security risk services to international companies. Mr Pool acknowledges intensified media coverage—such as the recent Ebola outbreak, or typhoon Yolanda's devastating impact in the Philippines, to name two recent examples—can amplify perceptions of physical risk. But CFOs' views of their companies' obligations in risky environments are also changing.

"Duty of care has become an item on the board-level agenda," Mr Pool says. "It's a law in certain Western countries that directors have a duty of care to employees to ensure safe work facilities and medical support. This mentality is now spreading to internationalising companies in the developing world, and also to fast developing China, where companies are going global."

Figure 5.10: Building a war chest

% respondents saying they will use surplus cash to increase cash reserves



Case study

Saumen Chakraborty, Dr Reddy's: Northern exposure

Rouble hedging done in the past helped Dr Reddy's offset currency volatility

In July 2014 the Russian rouble started falling, and kept on going. Brought on by the collapse in oil prices, the currency traded at 57 to the US dollar at the end of 2014, from 34 six months earlier—a massive drop in value. The fall had a sharp impact in Hyderabad, where Dr Reddy's Laboratories, a global pharmaceutical company, is based.

Dr Reddy's is one of India's Cinderella stories of international expansion. It started in 1984 with a single drug in a small facility near Hyderabad. It is now one of the top-three global generic drug makers in the world and the first Asian pharma company to be listed on the New York Stock Exchange. It has a presence in more than 20 countries and subsidiaries in the US, UK, Germany, Brazil and Russia, as well as joint ventures in China.

But with that global presence and its success in gaining footholds in developing markets comes substantial currency and geopolitical exposure. "We face not only currency risk but substantial geopolitical risk," says Saumen Chakraborty, CFO. "Our biggest concern in currencies now is in Russia, with the devaluation of the rouble. When it started falling, the drop was so severe, but only 30% of our cashflow was covered".

"What happens if you stay [in a troubled market] is that your relationships improve. Your customers feel you are there not just for the good times." Saumen Chakraborty, CFO

Mr Chakraborty concedes that the situation in the first quarter of 2015 is not fully played out. Some hedges ran out at the end of 2014 and the rouble's devaluation will probably deliver "a little larger hit". In the meantime, the company has been able to make some upward price adjustments, but this is a sensitive issue in any business, particularly a company that sells generic pharmaceuticals. "You cannot take price increase across all products by regulating. There are categories which are essential," including one of its best selling drugs, Omez, which treats peptic ulcers.

The currency mismatch—despite the hedges and the mitigating measures—led to an annual decline in sales from Russia of 10% in the December 2014 quarter. But without the currency exposure, sales are growing at a rate of 15% in 2014.

As currency volatility connected with the lower oil price developed in the second half of 2014, Dr Reddy's felt the pain elsewhere. In Ukraine, where it has a growing business, the hryvnia tracked the rouble's fall.

Venezuela is another challenging market. The company, Mr Chakraborty says, has made stunning inroads selling drugs there. "We crossed the US$100m dollar point in 2014," he says, speaking of annual sales. Dr Reddy's now faces the impact of Venezuela's complex 70% currency structure, launched in February by President Nicolas Maduro, involving a free-floating currency system featuring a three-tier hierarchy of exchange controls.

Mr Chakraborty says that in the case of the devaluation "you have to take the hit in P&L". As the situation developed, the company continued to repatriate funds to India at the exchange rate set for medicine and food. By the end of the year, the funds pending to be repatriated were estimated to be "in the vicinity of around US$40m" Mr Chakraborty says.

The conditions for business in Venezuela are brutal now, but Mr Chakraborty emphasises that in situations where exposure is a given, loyalty to a market can have its rewards. "Venezuela can be seen as a growth opportunity. We stayed in Russia during the 1998 and 2008 crises and developed our business there. What happens if you stay is that your relationships improve. Your customers feel you are there not just for the good times. Your market presence becomes deep and strategic."

Of course, Dr Reddy's exposure to multiple markets means it does have a natural hedge. In the fourth quarter, when the impact of the upheavals described above was being felt, sales in India and in North America, two of the company's biggest markets, grew by 11% and 4% respectively. Worldwide sales grew 9%.

Conclusion: Shouldering the risk, managing the reward

Asia's CFOs in 2015 are keenly aware of the higher risk and volatility ahead, but they are more determined than ever to lead their companies to growth

The results of this year's survey build a portrait of financial professionals in a changing Asia: waiting for tectonic shifts to occur and preparing for them, more risk-conscious but also more optimistic than in 2014. Across the board, CFOs are more positive about growth prospects than in the 2014 survey, when their responses were already upbeat. The attitude comes with a heightened concern over financial risk—which they nevertheless seem to take in their stride.

No illusions—but staying positive

Consider CFO Saumen Chakraborty of Indian pharmaceutical company Dr Reddy's, who manages receivables in a portfolio of shifting volatile currencies. Dr Reddy's has significant exposure in Russia, where the collapsing oil price pummeled the rouble. Moreover, the company has substantial exposure in war-torn Ukraine, and some exposure in Venezuela.

Despite these challenges, when Mr Chakraborty talks about Dr Reddy's prospects he emphasises huge opportunities for growth. "While we currently see our strongest growth market in the United States, we see tremendous growth prospects in the emerging markets, as well as in China and Japan."

Regarding his home market of India, "There was a time when we lost a bit of market share, because we didn't go all out, not in the way we have for the past two to three years." But the optimism that has emerged in India "cannot be attributed to only good luck," he says. Rather, it reflects an energisation of the economy that has been gathering pace for years, as a skilled workforce expanded and ideas of self-determination grew alongside India's knack for entrepreneurialism. "We have high expectations" of India now, he says.

Those expectations are all the more realistic because they come with no illusions about the difficulties that companies face in uncertain times. Dr Reddy's has the advantage of being a "disruptive" business model in global pharma, developing lower-cost generic drugs and seizing opportunities during a time when the biggest global pharmaceutical firms are adapting to price pressures, shrinking margins and regulatory risk.

Other companies in Asia are challenging the established business order, too. China-based online retail giant Alibaba launched the biggest IPO ever in September 2014. China's Xiaomi redefined the smartphone market by offering a powerful handset at price that almost anyone can afford (it has become the fifth biggest seller of handsets in India and is growing quickly elsewhere). And far from being off the agenda amid territorial disputes, business opportunities between China and Japan are as exciting as ever: Japan trading giant Itochu and Thailand's CP Group made a huge bet on their future in January 2015 by announcing a US$10.4bn investment into China's CITIC. Asian companies are funding Asia's future.

That's why the responses regarding China risk in this year's survey must be read with nuance. CFOs see China as the still greatest opportunity in the region, but also see sound management of the risks, as the economy and political system change, as essential. To take one example, Carlisle Companies, the US materials and technology maker, has restructured its presence in China and has moved some lower-cost operations to Oklahoma in the US while also automating some production, but it remains more committed to business on the mainland than ever.

This year's survey could be called the Asia CFOs' "Silver-Linings Playbook". Each element of looming risk has upside. No two nations in South-east Asia are more vulnerable to a sustained strong US dollar than Singapore and Indonesia. Yet many in these countries say this development will have a positive impact, as do many considering the implications of tighter US monetary policy. CFOs feel prepared for the volatility ahead, but are focused on the opportunity that lies beyond it. A strong US dollar and tightening by the US Federal Reserve are symptoms of growth, not ailment. CFOs are looking confidently at revival in a key market and factoring that into their attitudes and inputs into strategy.

People power

In 1994, at a low point in his storied career, Apple founder Steve Jobs said, “It’s not the tools… It’s the people you have faith in or not. Yeah, sure, I’m still optimistic; I mean, I get pessimistic sometimes but not for long.”[7]

CFOs’ faith in growth in this year’s survey reflects a focus on sound management, better engagement with the job, and confidence in the teams under them, rather than management fashion and the wonders of technology.

Not one of the interviewees in this study mentioned Six Sigma or comparable management trends. They are too busy seeking benefits from the reality on the ground, or as Michelle Liu, China CFO of German chemical company Lanxess says, “The CFO’s role to push more discipline into each process chain of company operations to optimise cash return becomes especially important in a volatile period like this.” But she emphasises the CFO’s role in building teamwork and incentives toward a common goal of growth and better management of risk.

The world may be changing, but CFOs in Asia are holding their companies’ ground by applying best practice. They can afford to be optimistic.

[7] Jeff Goodell, Steve Jobs in 1994: The Rolling Stone Interview, January 17th 2011. Available at http://www.rollingstone.com/culture/news/steve-jobs-in-1994-the-rolling-stone-interview-20110117

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