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Managing the upturn:
Key strategies for sustained profitable growth

CFERF Executive Research Report

January 2010

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Executive Summary

Managing the upturn: Key strategies for sustained profitable growth, offers a perspective of Canadian senior finance executives on the economy in 2010, anticipated risks to economic recovery, potential threats to companies, as well as key strategies that will dominate corporate Canada over the coming year. It also determines what finance executives see as the most critical financial management issues in 2010. The results presented are based upon a survey of over 200 senior finance executives across Canada and are also supported by an Executive Research Forum held in Toronto in late 2009.

Most senior finance executives participating in this research expect the Canadian economy to make a full recovery in Q3 and Q4 of 2010. For the most part, the cash crunch of 2008 and 2009 is over as credit conditions loosen and both private and public companies are fairly well positioned to meet their working capital requirements in 2010. Most companies are not looking to refinance in 2010, nor are they going to be selling off assets to keep afloat. However, very few executives anticipate a return to their 2008 spending levels.

Not surprisingly, senior executives are also bullish about their individual company performance during the year. Expectations for revenues and profit growth are positive, and companies will continue to focus on cost cutting to help improve their bottom lines. However, the days of widespread corporate downsizing are over. While most finance executives will still be keeping a close eye on costs, relatively few expect to be further reducing the size of their workforce going forward. In fact, almost one third will be increasing their staff in 2010.

Growing revenues and improving customer service will be the most popular strategies for companies in 2010. However, considerably more Canadian public companies will be focusing on increasing revenues through increasing sales volumes than privates, whereas improving customer service is important to substantially more private companies than publics. This by far will be the single most common strategy for Canadian private companies in the coming months. Customer retention initiatives, increased customer contact, and additional service offerings will likely underpin the strategy of revenue growth for these companies as they strive to improve their value added proposition, and gain marginal revenues on a per customer basis. For these companies, technology spends in 2010 are therefore likely to focus around building strong customer service platforms and processes.

Mergers and acquisitions (M&As) and market and product expansion will also be key areas of focus for many companies in the coming months. Of those executives who commented on their M&A plans over the next several months, just under half said they would be investing in purchasing other Canadian companies, and a large number of those will be in complimentary businesses. Companies will also be investing in increasing their product offerings and market share and many will be devoting new capital to R&D and productivity improving technology, particularly information technology related to improving customer management. Canadian public companies will be more inclined to acquire other companies in 2010 than their private company counterparts. However, it is still notable that over one in four private companies plan on making acquisitions in the next 12 months.

Capital spending plans differ slightly between public and private companies. For example, relatively more Canadian private companies than publics will be investing in new products and expanding markets. They will also be more likely to focus on building their cash positions and paying shareholders than public companies.

What then is going to keep Canadian senior finance executives up at night in 2010? With the lessons of 2008 and 2009 still top of mind, most CFOs will continue to keep a close eye on cash and liquidity, controlling costs and for public company executives, adopting International Financial Reporting Standards (IFRS). As expected, relatively fewer private company executives will be worried about adopting IFRS, but rather will be managing their liquidity and ensuring they have continued access to capital. Forecasting and risk management will continue to be critical for both. Going forward CFOs are more likely to rely on longer term forecasts rather than quarterly estimates due to the volatility in net income over the past 12 months.

WHAT'S KEEPING SENIOR FINANCE EXECUTIVES UP AT NIGHT IN 2010?

"Can China continue to run at a growth rate of eight and nine percent? What will the implications be for global recovery if they slow down?"

Kriss Bush, Vice President, RBC Dominion Securities

"Carbon costing and trading and the impact on our industry."

Kent Carson, Vice President Finance, Holcim Canada Inc.

"A combination of IFRS and the price of fuel at the pump."

Robert Clarke, Chief Financial Officer, British Columbia Ferry Services Inc.

"Will we get a W recovery, or are we on a steady growth path for 2010?"

Tom Evans, Chief Agent, GE Employers Reassurance Corp.

"Externally, the overall health of the economy, in particular consumer confidence. Internally, being able to continuously innovate."

Bobby Kwon, Chief Financial Officer, Unilever Canada

"Cash management and IFRS. My future concern would be the cost of hedging, liquidity and to some extent, counter-party risk."

Harald Ladewig, Vice President and Treasurer, Honda Canada Finance Inc.

"Government intervention."

Greg Scott, Chief Financial Officer, Maple Lodge Farms

"The labour market, unemployment and government spending."

François Vimard, Chief Financial Officer, Sobeys Inc.

"Without a doubt, the successful implementation of IFRS."

Vic Wells, Corporate Director, Audit Committee Member, and CFERF Trustee

"What I worry about all the time -- cash and taxes."

Tim Zahavich, Chief Financial Officer, St. Joseph Communications

Introduction

The outlook for economic recovery in Canada in 2010 is decidedly positive, with GDP growth spurred on by the increase in the global demand for commodities, the maintenance of low interest rates by both the Federal Reserve Board in the United States and the Bank of Canada, a strengthening of consumer demand for certain goods/assets on both sides of the border, and the flow through of federal government stimuli. However, while most of the news bodes well for Canadian companies, the recovery is likely to be bumpy, with varying degrees of momentum across provinces and between sectors. Canadian exporters particularly, are keeping a close eye on the level of the Canadian dollar against the US greenback, with the view that the higher the dollar, the greater the potential to choke off demand.

On a micro-level, the extent to which Canadian companies will experience growth in revenues and profitability over the coming year is dependent upon a myriad of factors that are unique to each market, industry structure, and financial circumstance. For example, the recession has presented some opportunities for financially healthy organizations in certain sectors to get stronger, as they gobble up cash strapped companies that couldn't access credit over the past year. These companies will be well positioned to capitalize on a return to normal demand conditions, while others that have lost skilled labour and other productive assets to massive rounds of downsizing and cost reduction, will be more challenged to ramp up their capacity over the coming months. Companies who will be focused on improving operational efficiencies over the period and who are in strong cash/credit positions will be looking to invest in new productivity enhancing technologies, while others will be seeking new markets, products and pricing models to capture what could be permanently altered patterns in consumer spending in some sectors.

This study attempts to offer the point of view of senior financial executives on the timing and characteristics of the economic recovery in Canada. In so doing, it will address the key strategic management issues they will be focusing on over the coming months and the challenges/opportunities they face in their respective companies and industries. It will also examine some practical financial management issues related to forecasting, risk and cash management and cost management. Ultimately, it will present their views on what will be keeping CFOs up at night in 2010.

Research Methodology

Managing the upturn: Key strategies for sustained profitable growth was prepared by CFERF and was sponsored by Ernst & Young Canada. It encompasses both the results of a survey of senior financial executives from public and private companies across Canada and the insights obtained through an Executive Research Forum held in Toronto on October 29, 2009.

The intent of the survey was to provide a broad view of Canada's economic prospects for 2010 and the underlying issues facing companies, what their areas of focus will be in terms of financial management, and what strategies they intend to employ to generate increases in revenue and profitability. More than 200 responses were obtained in October of 2009 (Please see Appendix A for survey demographics).

The majority of survey respondents were senior financial executives from companies with revenues of less than $250 million and most were located in Ontario, British Columbia and Alberta. Roughly half of respondents held the position of CFO. Relatively more private than public companies are represented in this sample, and the vast majority (81.9%) reported Canada as being their primary market. However, a large proportion of the companies in our sample (37.6%) were also highly dependent on exporting to the US. The top three sectors represented are financial services, manufacturing, and professional, scientific and technical services.

The second phase of the research methodology included capturing the feedback from senior financial executives who took part in a half-day Executive Research Forum. The purpose of the forum was to allow for a free-flowing dialogue between company experts who were provided with specific questions in advance. A wide range of industries were represented including heavy construction; financial services; transportation; information technology; consumer and personal care products; food production and processing; retail grocery; printing and publishing.

Overview of the Canadian Economy

The majority of senior finance executives, especially in Ontario and Alberta, predict a return to normal output in 2010, most likely in Q3 and Q4. Real demand is expected to rise, reflected in an increase in company revenues, sales volumes and a rise in prices.

FORECAST FOR ECONOMIC RECOVERY

2009 was characterized by winners and losers. For some, overall corporate performance improved over the period, while others lost ground. More precisely, our survey shows that in October of 2009, for example, more than one third of survey respondents (38.6%) said that their companies were in a better position now than in October of 2008, compared to 30.2% who said that they are in about the same shape, and 31% whose companies are worse off.

When looking to the future, expectations for economic recovery suggest that improvement in corporate performance will be widespread. Most senior financial executives across the country expect the Canadian economy to return to normal growth rates in 2010 (60.4%), and the second half of the year is likely to be better than the first. More predict economic recovery in Q3 and Q4 (41.6%), than in the first half of the year (18.8%). One in four remain more cautious, expecting the recovery in 2011 while relatively few, 7.4%, saw 2012 as the year we return to more traditional rates of growth. Views between executives from private companies and publicly listed companies were fairly consistent with 66% of privates vs. 60.7% of public company respondents forecasting the recovery for 2010. Again, relatively more executives in both private and public companies forecasted a return to growth in the second half of 2010.

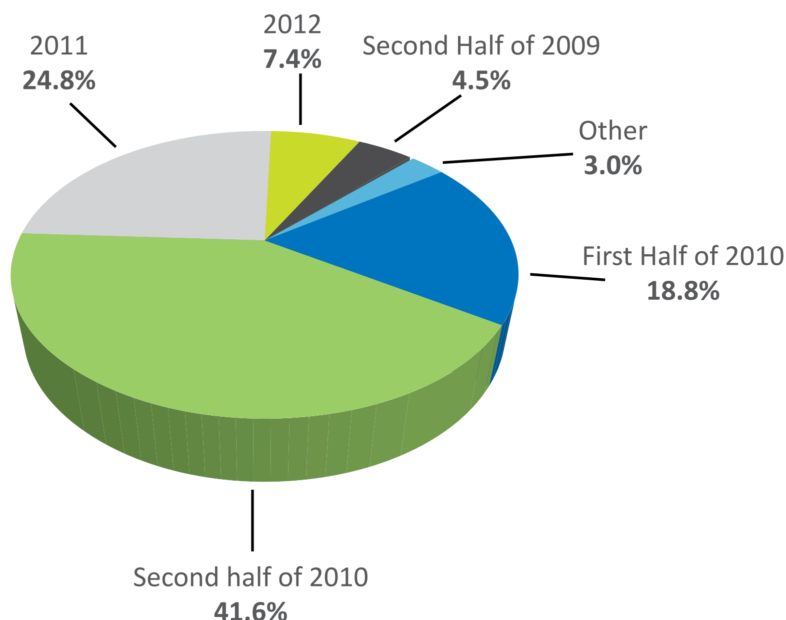
In order to determine if there were any differences in views between respondents from different industries, individuals were asked to identify their companies according to twenty large SIC (Standard Industrial Classification) groupings. The largest number of respondents were from finance and insurance sector (25), followed by manufacturing (23), and professional, scientific and technical services (21). The remainder was distributed widely among the remaining industry groups.

Roughly 35% or 82 respondents represented companies with annual revenues of less than $49 million, and 49 of those were from private companies. This was followed by 28.4% from companies in the revenue range of between $50 million and $250 million. Twenty eight or 11.9% reported their companies had revenues between $1 billion and $4.9 billion, followed by 18 or 7.6% in the $500 million to $999 million range. Fourteen companies responding to our survey had annual revenues of more than $5 billion dollars – nine were public, four were private, and one was a not-for-profit.

While on average, the Canadian economy is expected to be in pretty good shape going forward, the outlook varies by province. For example, senior executives from Ontario (69.4%) and British Columbia (68.8%) were more likely to be optimistic for recovery by the end of 2009 and throughout 2010 than elsewhere in the country, potentially reflecting greater expectations for growth in output in large key sectors such as financial services, manufacturing, automobile production and parts, wood products and construction.

Not surprisingly, senior executives who predicted solid recovery in 2010 also felt bullish about their individual company performance during the year. Overall, 64.5% of respondents expected their company's revenues to grow throughout the year (67% private, 60.7% public). Most (61.9%), expected an increase in sales volumes, combined with a hike in product prices (42% of companies represented in this survey are likely to increase their prices in 2010). Again, companies in Ontario, British Columbia and Alberta had a more positive revenue outlook than the country average.

IN WHAT YEAR DO YOU EXPECT THE CANADIAN ECONOMY TO RETURN TO NORMAL GROWTH RATES?



ECONOMIC RISKS - INFLATION, EXCHANGE RATES, CONSUMER CONFIDENCE

For every upside forecast, senior finance executives are also keenly aware of the potential downside risks. For the economy as a whole, three highly inter-related risk factors were seen as having the greatest potential to dampen the recovery going forward, namely; inflation accompanied by a potential rise in interest rates, a high Canadian dollar that will continue to choke off demand for exports to the US, and weaker than anticipated consumer confidence that could cause spending to be deferred.

The significance of macroeconomic risks will vary across regions within Canada according to the structure of local economies, i.e. reliance on exports and major manufacturing sectors , the nature of local resources and labour markets, and a host of other factors that define local economic infrastructures and consumer demand conditions. However, three significant risk factors stood out as having potentially wide-sweeping impacts across all provinces and industries, namely inflation, exchange rates, and consumer confidence.

INFLATION AND INTEREST RATES

Although respondents had generally positive expectations for economic recovery in 2010, the vast majority of senior finance executives answering our survey were concerned about inflationary pressures emerging in the following year. Roughly 70% of respondents anticipate that inflation will be somewhat or very problematic by 2011. The general worry is that Inflation will choke off domestic demand as prices increase in the short term while wages are relatively fixed. At the same time for exporters whose sales are in fixed-dollar contracts, inflation will erode domestic margins as local input prices rise. Similarly, even when prices are not fixed in foreign currency terms, domestic exporters may not be able to pass price increases on to their buyers simply because of demand conditions in the US and elsewhere.

Senior finance executives in private companies are slightly more concerned about inflation than their public company counterparts, with 72.5% seeing rising prices as being somewhat or very problematic, versus 66.1% in public companies. Inflationary pressures in 2011 are generally worrisome across the country; however, they are of greatest concern to Ontario executives with 75.3% indicating that inflation will be a problem, followed by 73.8% in Alberta and 68.8% in British Columbia.

EXCHANGE RATES

While we didn't gather data on the potential impact of exchange rates on the Canadian economy, a rising Canadian dollar was mentioned by many forum participants as a key influence in the recovery. For those concerned about exporting to the US, a high Canadian dollar could clearly threaten demand south of the border. Says Tim Zahavich, CFO of St. Joseph Communications, Canada's largest privately- owned content, printing and media company, "We're very concerned about the dollar going higher because not only are we losing our export markets, we're also being challenged from US competitors selling into Canada because it's become so much cheaper for them to do so."

In contrast, others view a high Canadian dollar as an opportunity to make improvements to their productive capacity. According to Greg Scott, CFO of Maple Lodge Farms, Ltd., the largest independently owned poultry processor in Canada, "The Impact of a strong Canadian dollar on the economy is a double-edged sword. On sales, if you're an exporter, it certainly hurts. On the other hand, it is a wonderful opportunity to spend some money in your plant and upgrade your equipment, most of which tends to come from outside Canada and therefore gets paid in US dollars. It's a wonderful opportunity to position yourself in a better place for the recovery and maybe help you become a lower-cost provider of the product that you have. We've done just that by completing a large plant expansion."

CONSUMER CONFIDENCE

Consumer confidence was also viewed as a key indicator of future economic performance by many senior executives taking part in our research forum. For some, current levels of consumer spending and changing consumer patterns are causing them to be less optimistic about the strength of the recovery in 2010. For instance, Bobby Kwon, CFO of Unilever Canada (a subsidiary of Unilever, one of the world's largest publicly-listed manufacturers of food and personal care products), is concerned that he has yet to see a return to pre-2008 spending patterns. Says Kwon, "We have a real time pulse of our consumers,"… and our sense is that they're still very much on the sidelines and cautious as evidenced by fewer shopping trips often with lower 'basket ring' and/or deferring purchases all together. What we've seen is a structural change in the way consumers look at value now and it's not a temporary phenomenon. There seems to be almost a permanent step down in terms of how they perceive value, and I think through that lens, it's going to be some time in terms of recovery coming back in a sustainable way."

The level of consumer confidence is also fundamentally related to the way people will invest their money in 2010. For example, according to Kriss Bush, Vice President at RBC Dominion Securities, "Consumers who aren't spending are saving their money. Even jittery retail investors – still in shock from the recent market crash – are investing their cash in safe and secure investments." In fact, says Bush, the ongoing flight to safety is so widespread that Canada's wealthiest investors are snapping up triple A-rated bonds so quickly that average retail investors don't have a chance to buy them.

COMPANY RISKS

Consistent with the view that the Canadian economy will recover by the second half of 2010, financial executives don't foresee a decline in sales, or profits, nor are they particularly concerned about increased competition or shrinking markets. Over 63% of finance executives are either "not at all" concerned or only "somewhat" concerned about these issues heading into next year. For those that are worried about these risks, private companies are concerned about falling sales and collecting on accounts receivable while public companies are more concerned about decreasing profit margins and access to capital. Both tend to worry about the impacts of industry consolidation.

In order to determine what specifically executives were concerned about relative to their own company's situation for 2010, we asked about nine additional risk factors and their potential significance in the coming year. For each of the risk factors in question, the majority of respondents in our survey (at least 63%) are either "not at all" worried that they will be an issue next year, or that they will be only "somewhat significant". The remainder thought that they were either "significant" or "very significant" risks and these are the results we present below. For these remaining company executives, the four most commonly cited risks for 2010 are declining margins, access to capital, declining sales and shrinking demand and markets. However, private companies and public companies will likely face somewhat different challenges in 2010.

For example, private company executives are more likely to say they worry about declining sales, collecting on outstanding accounts and shrinking demand and markets. Relatively more Canadian public company executives are worried about falling profit margins (47%) and access to capital (42.8%) than private company respondents. Public company executives are also more likely to worry about increased competition from new foreign and domestic competitors than private company executives; however, both (roughly one in four) are concerned about increased competitive pressures due to mergers and acquisitions. The fewest number of respondents considered falling asset values to be a risk going forward into 2010.

SIGNIFICANT COMPANY RISKS IN 2010

	TOTAL*	PRIVATE **	PUBLIC***
Declining margins	37.6%	38.6%	47%
Access to capital	34.1%	38.2%	42.8%
Declining sales	31.6%	36.6%	25.4%
Shrinking demand/markets	30.5%	37%	26.4%
Industry consolidation	23.5%	25.8%	24.5%
Collecting accounts receivable	21.1%	26.6%	17.3%
Foreign competitors	17.8%	16.8%	20%
Domestic competitors	16.3%	16.2%	23%
Falling asset values	14.1%	14.1%	16%

* Total Includes Crown Corporations, U.S. Subsidiaries, Not-for-Profits, and other companies.
** Canadian private companies.
*** Canadian public companies.

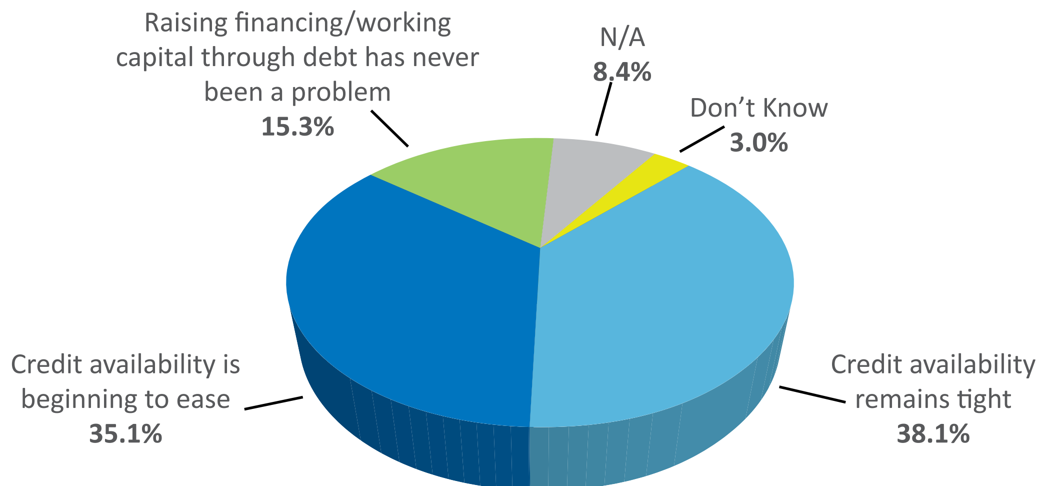
CREDIT CONDITIONS

Views on credit market conditions are mixed. Approximately 38% of finance executives feel that credit markets have remained tight over the past six to nine months, while roughly 35% believe that they have somewhat loosened. However, in 2010 most companies are likely to be in a favorable position with respect to financing. The vast majority of financial executives are not expecting a refinancing or change in capital structure in their companies, nor are they expecting their companies to shed assets to raise capital.

One of the key characteristics of the economic downturn in Canada was the inability of companies to access credit. Tight credit conditions prevailed over the latter half of 2008 and well into 2009. Going forward, a return to economic growth is contingent upon whether or not companies will have adequate working capital or whether or not they will be able to finance their expansion plans.

Today, views on credit availability are mixed. Over 38% of respondents indicated that credit markets have remained tight over the past six to nine months; however, roughly the same number (35.1%) said they were beginning to ease. At the same time, 15.3% said obtaining financing had never been a problem. As credit markets improve, 55.9% said it will be easier for them to obtain financing, while 31.2% expect no change.

TO WHAT EXTENT HAS THE CREDIT MARKET CHANGED OVER THE PAST SIX TO NINE MONTHS?



"Getting capital is not the issue anymore; it's what you're going to do with that capital and whether or not your customer is going to be there to buy if you improve your capacity or productivity. At the same time, capital projects are less costly. Two years ago we delayed building some stores in Western Canada because it was too expensive. Now we can build stores there at a 20% lower cost than we could in 2007."

– François Vimard, Chief Financial Officer, Sobeys Inc

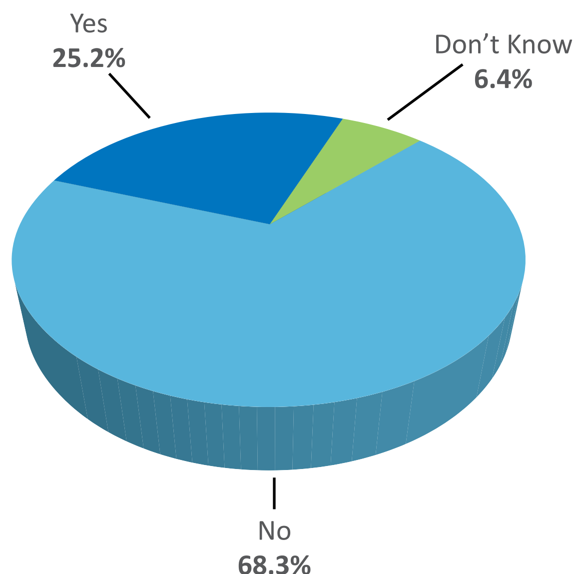
CAPITAL ADEQUACY AND SPENDING FORECASTS

Overall, companies are expected to have enough capital in 2010 to meet regulatory requirements, shareholder expectations, invest in property, plant and equipment, and maintain adequate working capital. Most are not seeking refinancing in 2010, nor will they be changing their capital structure. The majority of companies will be investing in new products or market expansion, in technology (particularly IT systems) and research and development. More than half planned to build a cash safety net and two in five plan on acquiring other companies in 2010. To be sure, mergers and acquisitions will be a big part of companies' investment initiatives, with one in two public companies, and one in four private companies, investing capital in acquisitions in 2010.

The 2010 outlook for most companies in terms of capital adequacy is rosy. For instance, 76.6% of companies for whom the question was relevant said they expected to have enough capital to meet regulatory requirements in 2010; and 74.7% of companies said they expected to have adequate capital to meet shareholder expectations. Similarly, 69.5% of companies expected to have adequate working capital in 2010, as did 66% of companies who required capital for property, plant and equipment. Finally, over half (53.4%), stated they expected to have enough capital in 2010 to embark on a business expansion. This compares with 36.2% whose capital would fall short to meet expansion plans, and 5.7% who indicated they would be over capitalized (all results excluded respondents who said the question did not apply to them).

Consistent with the positive capital positions of the majority of companies represented in our survey, most (68.3%) will not be looking to refinance in 2010. Similarly, the majority will not be changing their capital structure (64.9%), although 16.8% said they will be assuming more debt.

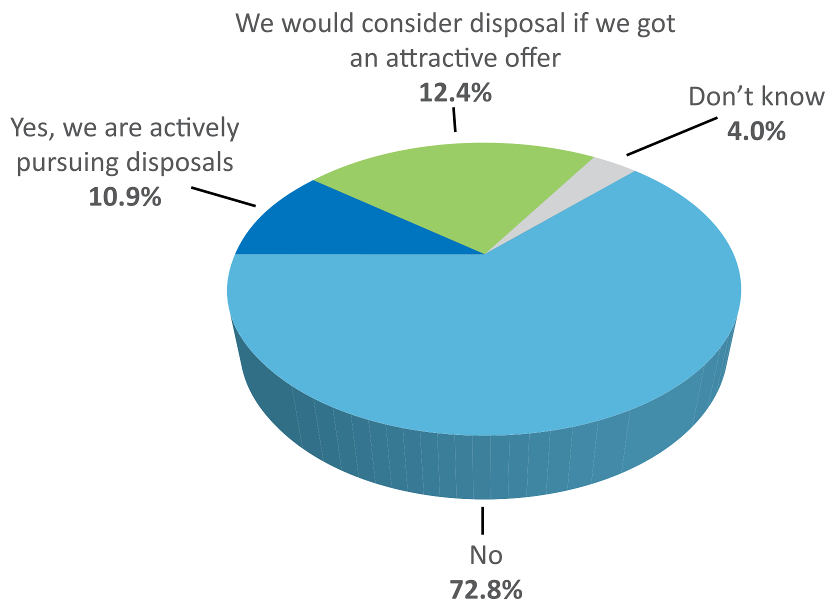
WILL YOUR COMPANY BE REQUIRED TO REFINANCE ANY OF ITS CAPITAL IN 2010?



Of those companies that will be seeking alternative forms of financing in 2010, the preferred method was equity (46%), followed by asset-based loans (42%); subordinated debt (22%); accounts receivable factoring (12.7%); and mezzanine capital (11.7%). Other forms of financing mentioned included: partnerships, sale/leaseback arrangements, private loans, parent company financing, and asset sales.

When asked specifically about plans to shed assets, such as subsidiaries or a line of business to raise financing, the vast majority (72.8%) said this was not in their plans; 10.9% said they were actively pursuing this option, and 12.4% would consider it if they received an attractive offer.

IS YOUR COMPANY CONSIDERING DISPOSALS (E.G. SUBSIDIARY, LINE OF BUSINESS, ASSETS) TO RAISE FINANCING?



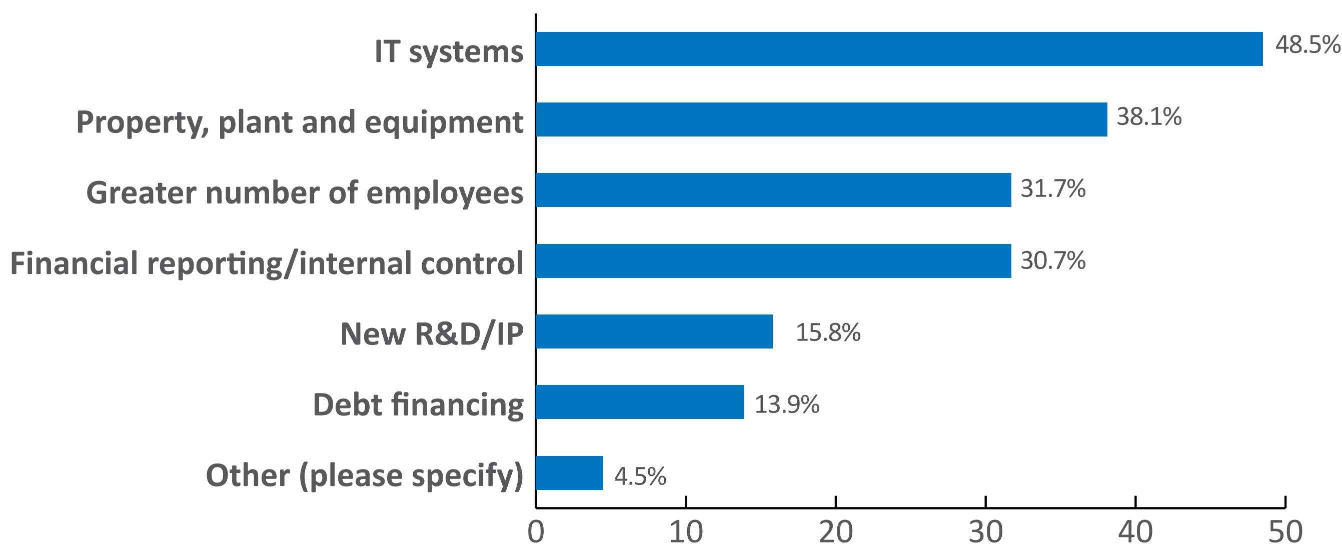
FOCUS ON SPENDING

Canadian private companies are more likely to be the engine of product and market expansion in 2010 than public companies, who are more concerned with acquiring other firms. However, Canadian publics are better capitalized than their private company counterparts, and more likely to be adequately financed in order to meet their overall expansion plans in 2010.

While the vast majority of finance executives agreed that capital spending would fall short of 2008 levels (80.6%), increases in 2010 can be expected in five major areas; namely; building cash positions, technology and R&D, new products/market expansion, acquisitions, and pay outs to shareholders.

Most companies will be investing in new products and expanding markets (61.9%), followed closely behind by new technology and research and development (58.4%). Others were planning to build a safety net by increasing their cash position (51.5%). At the same time, many companies (44.1%) also planned to acquire others as well as pay out cash to current shareholders (31.8%). However, when asked about non-essential or discretionary spending, the picture changes somewhat. Nearly half (48.5%) of companies surveyed said they were likely to increase their spending on IT systems, compared to 38.1% who said they would increase spending on property, plant and equipment. Approximately 32% planned to hire more staff and roughly the same number (30.7%) planned to spend more on financial reporting and/or internal control. A minority of companies planned to increase discretionary spending on R&D (15.8%), while 13.9% planned to increase outlays for debt financing and 4.5% planned to increase spending in other areas, including marketing, advertising and training.

ARE YOU PLANNING ON INCREASING DISCRETIONARY SPENDING FOR 2010 IN ANY OF THE FOLLOWING AREAS? (PLEASE CHECK ALL THAT APPLY)



PRIVATE VS. PUBLIC COMPANY CAPITAL SPENDING

Capital spending plans change according to whether companies are public or private. For example, relatively more Canadian private companies (71.4%) than publics (57.1%) will be investing in new products and expanding markets. They are also more likely to be focused on building their cash positions (58.2%) than public companies (50%) and paying shareholders (37.4%) than publicly listed firms (14.3%). Meanwhile, we see that Canadian public companies are more inclined to acquire other companies (53.6%) in 2010 than their private company counterparts (27.5%); however, it is still notable that roughly one in four private companies will be allocating capital for acquisitions in the next 12 months.

While both Canadian private and public companies across the country are well positioned to meet their working capital requirements (80.2% of private and 82.1% of public companies), Canadian publicly-listed companies with access to public capital markets are better positioned to meet their planned capital spending initiatives (57.1% of Canadian public companies are adequately capitalized to meet expansion plans in 2010, compared with 42.9% of Canadian private companies).

Strategic Directions

Growing revenue and improving customer service top the list of corporate objectives for 2010. The majority of companies in our survey will be focusing on increasing domestic sales. However, growth in overseas markets will also be a major focus for Canadian exporters, with one third of all companies in our study focusing on this strategy. While cost reduction remains an important factor to half of companies surveyed (54.5%), relatively few (12.9%) are expecting to downsize their operations in 2010.

With the return to economic prosperity in 2010, companies across the country are implementing a variety of strategies to ensure their companies are well positioned to capitalize on market opportunities.

In order to determine where companies will be putting their efforts in 2010, we asked senior financial executives to tell us what their primary areas of focus will be for the next 12 months.

CRITICAL FACTORS IN CORPORATE STRATEGY FOR 2010

	TOTAL*	PRIVATE**	PUBLIC***
Growing revenues	79.7%	66.9%	80.3%
Focus on customer services	79.2%	85.8%	64.3%
Increase in volumes (domestic sales)	63.4%	68.3%	73.3%
Technology improvements	61.9%	57.2%	66.1%
Continue at current output level	59.9%	58.3%	55.4%
Reduce costs (other than downsizing)	54.5%	51.7%	66.0%
Supply chain efficiency	39.1%	38.5%	39.2%
Increase product range	32.8%	30.8%	37.5%
Increase in volumes (overseas sales)	31.7%	33.0%	37.5%
Increase prices	29.7%	29.7%	28.5%
New distribution channels	26.9%	30.8%	30.3%
Focus on new suppliers	21.8%	25.3%	17.8%
Inventory liquidation	18.3%	19.8%	14.3%
Downsize	12.9%	7.7%	14.2%
Other	9.0%	3.3%	3.6%

* Total Includes Crown Corporations, U.S. Subsidiaries, Not-for-Profits, and other companies.
** Canadian private companies.
*** Canadian public companies.

Growing revenues and improving customer service will be the most popular strategies for companies in 2010, with almost 80% of all respondents agreeing that these will be either important or very important factors in their overall plans. However, considerably more Canadian public companies will be focusing on increasing revenues through increasing sales volumes than privates, whereas improving customer service is important to substantially more private companies than publics and, will by far be the single most common strategy for Canadian private companies in the coming months. Customer retention initiatives, increased customer contact, and additional service offerings will likely underpin the strategy of revenue growth for these companies as they strive to improve their value added proposition, and gain marginal revenues on a per customer basis. For these companies, technology spends in 2010 are therefore likely to focus around building strong customer service platforms and processes.

Increasing sales volumes also goes hand in hand with revenue growth, and increasing volumes in the domestic market specifically, was considered to be important or very important by 63.4% of respondents. This strategy will be common to both private and public companies alike. At the same time, overseas market growth was important to more than roughly one third of both private and public Canadian companies. This reflects the proportion of companies in our survey whose primary markets were also located in the US or internationally. If increasing sales volumes is a priority for companies, it is not surprising then that many appear reluctant to raise prices as a strategy to increase revenue. Only 29.7% of companies anticipated price increases in 2010.

Improving customer service during the downturn was seen as a major revenue generating possibility for BC Ferries Inc., says CFO Robert Clarke. The recession resulted in the emergence of the so-called "staycation" – families find activities to do close to home rather than travel abroad. "We're actually moving into creating a BC Ferries business unit whose job it will be to not only just provide service back and forth, but a place to go – some activities to do – and hopefully take something off the top of that," Clarke said. "And I think if we can make a success of that, and I have a high degree of confidence that we can, we may be able to maintain that staycation mentality just a little longer." Clarke said that he recognizes that while the "staycation" represents a growth opportunity for a niche market, it may have broader implications for other sectors and industries.

Increasing profit margins is also an underlying theme for companies across the board as many continue to emphasize cost reduction in 2010 (54.5%), accompanied by improvements in technology (61.9%) and increasing the efficiency of their supply chains (39.1%). Relatively fewer companies will be looking for new channels of distribution (26.9%) in the coming months or seeking out alternative sources of supply (21.8%). However, Canadian private companies are more likely to be looking for new suppliers in 2010 than Canadian publics. At the same time, roughly 20% of private companies will continue to be selling off last year's inventories by reducing prices, compared to 14.3% of publics.

For an IT solution provider like Hartco, it makes sense to invest in technology during a slower period. We already had a plan to integrate our systems to be more efficient, but given the slow state of the business, it was a good time to embark on those projects to be ready when the economy likely picks up in 12 months or 15 months. In 2009, we launched a major integration project for our business and while we are looking to reduce costs, we are really investing to enhance the customer experience and create better tools for our customer facing associates… to integrate from order to cash – the whole thing – and create more value add for the customer and the shareholders. That's an area where we have a significant opportunity."

– Carl Gauvreau, CFO, Hartco Inc.

SPOTLIGHT ON COST CUTTING

Slimmer budgets are here to stay, at least for now. Very few companies said they planned to restore 2010 spending to 2008 levels. Overall, previous company efforts to cut costs were carried out as anticipated, and the majority felt the cuts had not put them at a competitive disadvantage.

Companies will continue to trim costs in the next 12 months; however, only relatively few will continue to downsize employees. As previously mentioned earlier in this report, over half of the respondents in our survey indicate that their companies will continue to focus on cost cutting in 2010. However, further staff cuts are only anticipated by 12.9%, indicating that the massive layoffs witnessed in 2009 have come to an end.

The majority of companies who cut costs in 2009 (66.3%) were successful in meeting their targets; however, roughly 20% of respondents indicated that they had cut less than expected. Be that as it may, only a very small percentage indicated that they had not achieved their goals. While, the vast majority of respondents didn't feel that these initiatives put their companies at a competitive disadvantage (79.5%), roughly one in ten said that it did. This held true for respondents from both private and public companies where 12.1% and 10.7% respectively thought that their companies were in a competitively weaker position after cutting costs.

A common method of reducing costs without downsizing is to more closely manage inventory. Of those respondents who said that inventory was relevant to their companies, 42.1% would be reducing excess capacity and 38.9% said they planned to run a 'just-in-time' inventory system. About one-third (32.6%) said they would also consider incentives to reduce inventory. Only 6.3% said they would stockpile and build inventory.

COMMON ISSUES IN COST CONTROL

Cost-cutting methods included typical reductions in discretionary spending items such as travel and entertainment. Honda, for instance, eliminated its adult staff holiday party in Canada but maintained the event for children, said Harald Ladewig, Vice President and Treasurer of Honda Canada Finance Inc. Other methods include deferring, rather than eliminating, certain expenses. For instance, General Electric had delayed all laptop computer purchases for its 300,000 plus employees for one year, said GE Employers Re Chief Agent Tom Evans.

Many companies had to resort to more serious cost control measures to protect their bottom line. Cuts to staff compensation were needed at St. Joseph Communications, a printer and publisher of magazines such as Toronto Life, Canadian Family and Fashion Magazine, which like other media companies, suffered dramatic losses in advertising revenues. According to company CFO Tim Zahavich, St. Joseph had to cut benefits, RRSP contributions, and introduced unpaid days off. Other companies, like Honda Canada, in addition to complying with a global company-wide wage freeze, eliminated temporary and contract employees and reduced spending on consultants.

"Like any other business decision, reducing head count has to be strategic, or it could pose longer term problems for your company," explains Robert Clarke, CFO of BC Ferries. "When making labour cuts," says Clarke, "often companies offer voluntary severance packages and buyouts. The most qualified, mobile staff take the packages and leave." To avoid this, BC Ferries made a pre-emptive move and laid off certain staff selectively. "Then," says Clarke, "we were able to stand up and re-assure the balance of the people in that part of the business that we were done. This allowed us to bring back a sense of confidence in the workforce so that we didn't continue to lose good people."

SPOTLIGHT ON MERGERS AND ACQUISITIONS

Roughly 45% of senior executives commenting on the acquisition activities of their companies indicated that they will be looking to acquire another company in 2010. Of those, more specifically, 65% of Canadian public companies and 40% of Canadian private companies are expected to be making an acquisition in the next 12 months. Approximately 40% of those acquisitions will be of complementary companies.

Merger and acquisition activity has rebounded throughout 2009. For example, recent reports of deal activity in Canada[1] for the first half of 2009 show a dramatic change in the number of transactions between Q1 and Q2 with the number of new deals increasing by 28%. While the total transaction value decreased over the period from $47.6 billion to $24.9 billion due to fewer mega deals, the mid-market, or transactions valued at under $250 million were particularly strong, accounting for 88% of all transactions volumes in the period. Q3, however, saw a surge in the value of transactions by 27%, accompanied by an increase of 12% in the number of acquisitions over the period[2].

For 2010, we expect continued momentum in the mergers and acquisitions space. Roughly one third or 67 of the 202 senior finance executives responding to our survey indicated that they will be devoting new capital to acquisitions in 2010. Eighty nine or approximately 44% will not be devoting new capital to acquisitions in 2010, and 15% don't know. Of those senior finance executives who indicated that their company planned on buying another company, 19% were targeting direct competitors, 42% were planning to acquire complementary companies and 39% were open to all opportunities.

M&As in the pharmaceutical industry demonstrate the many factors driving acquisitions in Canada at this time. For the industry as a whole, explains Paul Van Damme, Chief Financial Officer at Bradmer Pharmaceuticals Inc., the reason why pharmaceutical acquisitions are going to continue to increase in both size and volume is because large pharmaceutical companies are increasingly having difficulty in developing their own drugs in-house. Says Van Damme, "Not since Viagra was invented accidentally by Pfizer has there been a single blockbuster drug. So, in order to make up for that lack of drug development, and the patents expiring on cholesterol drugs, which are the largest selling drugs in the world, there's going to be an attempt by pharmaceutical companies to acquire their competitors." Furthermore, he says, "Companies are acquiring smaller private companies to reduce costs, not to grow, but, reduce costs. So, they'll cut out waves of sales and R&D people. At the same time, pharmaceutical companies are increasingly looking to purchase smaller niche companies with highly specialized product lines. As Van Damme explains, "Bio-tech companies typically are now the research and development engines for the pharmaceutical industry. And, again, they too will see a large increase in acquisitions."

[1] September 2009. Crosbie & Company Inc. "Canadian M&A Activity – Second Quarter 2009 Report"

[2] Reuters, November 30, 2009. Crosbie & Company Inc. "Canada's M&A Volume Climbs Again in Q3"

Critical Financial Management Issues

TOP ISSUES FOR SENIOR FINANCE EXECUTIVES IN 2010

The top three areas of focus for public company CFOs in 2010 will be managing cash and liquidity, cost control, and adopting IFRS. Private company executives will have a similar focus; however, as expected, considerably fewer will be worried about adopting the IFRS, but rather will be focused on managing their treasuries and access to capital.

CFOs and other senior finance executives will be busy implementing their company's growth strategies for 2010. However, the role of the senior finance executive not only involves taking the necessary action to ensure that their company's strategic financial management is in line with overall corporate objectives, but that the everyday administration of the company is carried out effectively, that compliance and control objectives are met, and of course that quarterly reporting is complete and transparent.

The typical purview of the CFO, for example, includes financial reporting, compliance, treasury and risk management, internal control, budgeting, forecasting, cash management and liquidity, due diligence and financial analysis of acquisitions, investment planning, cost control, and oftentimes information systems, the management of which absorbs tremendous amounts of time and energy. In order to determine where senior finance executives will be putting their efforts over the next several months, we asked our respondents to rate the relative importance of several key financial management areas. The following results are for those areas that will either be "important " or "very important" to all respondents as well as show the differences and similarities in focus between senior finance executives in Canadian private and public companies over the coming year.

AREAS OF FOCUS FOR SENIOR FINANCE EXECUTIVES IN 2010

	TOTAL*	PRIVATE**	PUBLIC***
Cash and liquidity management	77.7%	81.4%	82.1%
Cost management/reduction	73.2%	70.4%	76.8%
Financing and treasury management	58.9%	67.1%	66.1%
Internal control	49.5%	41.8%	50.0%
International Financial Reporting Standards	38.1%	22.0%	69.6%
Acquisitions	28.3%	24.2%	44.7%
Investment Planning	28.2%	20.9%	39.3%
Other	9.0%	6.6%	8.9%

*** Total Includes Crown Corporations, U.S. Subsidiaries, Not-for-Profits, and other companies.**
**** Canadian private companies.**
***** Canadian public companies.**

The top three areas of focus for senior finance executives in 2010 will relate to making sure the company has enough working capital to make it through the year. As it was in 2009, cash and liquidity management will be a key area of focus for the largest number of senior finance executives across the country (77.7%), followed by cost management and cost reduction (73.2%) and financing and treasury management (58.9%).

There is little difference between the views of private versus public company executives on this matter. Where we do begin to see disparate opinions relates to compliance, reporting and investments. Relatively more public company executives (50%) will be focused on their control environments in 2010 than private company executives (41.8%), likely due to the mandatory public company certification requirements pertaining to internal control over financial reporting. Similarly, mandatory filing under IFRS will only affect Canadian publicly accountable companies, and therefore we see a large disparity in the results between the two groups. Finally, more public company finance executives will be focusing on investment planning than private ones, which is also reflected in the relative number of companies that will be absorbed in acquisitions over the coming year.

SPOTLIGHT ON FORECASTING AND RISK MANAGEMENT

Over half of senior finance executives said their forecasts for net income were either totally inaccurate, or only somewhat accurate in 2009. Looking ahead, less than half of respondents said they felt comfortable forecasting six to 12 months with any degree of precision. Far fewer (about one-third) reported feeling comfortable making shorter-term forecasts.

Forecasting and budgeting during the economic downturn have been major pain points for senior finance executives across the country, in both private and public companies. Quarterly volatility in revenues and net income from both large variances in sales and return on assets, combined with accompanying short-term cost cutting and other emergency measures to ensure that companies remained liquid, goes far in explaining why budgeting during this period was somewhat hit and miss. In order to determine what were the most difficult areas in forecasting for 2009, survey respondents were asked how accurate their estimates were in three areas, namely; cash, revenues and net income.

The greatest number of senior finance executives had poor results when it came to forecasting net income, with over half indicating that they were either not at all accurate (more than 50% variance from estimates) or only somewhat accurate (between 20% and 49% variance). This was followed closely by estimates of revenues (48%) and then cash (43%) forecasts being either completely inaccurate or only somewhat accurate. Quarterly forecasting is likely to continue to pose difficulties in 2010 reflecting what many believe could be a rather bumpy recovery. Looking ahead, more companies (46%) said they felt comfortable forecasting six to 12 months with some degree of precision, than they did for forecasts of less than six months (33.7%).

"BC Ferry Services Inc., a 50-year-old operation with fairly rigid costs, was startled to find their 2008 top-line revenue was $45 million off the forecast (total 2008 revenue was $640 million). This occurred after a deep value analysis stating that even in a worst-case scenario, there was no chance their forecast would be more than $20 million off, or roughly 3%. "The volatility that was created in what's been a historically a very, very stable company was stunning and dare I say frightening," recalled CFO Robert Clarke. This year, again, you have a new reality now, so this year we're off by two and a half, three, maybe four million by the end of the year. And we're all thinking that's pretty damn good."

"Due to the volatility, what we found is that ironically a forecast three months out is more accurate than four weeks away. Rather than putting a lot of wasted energy on trying to land on a pinhead, we utilize range forecasts with a robust list of key opportunities and risks to dynamically (re)allocate resources to respond to marketplace developments."

– Bobby Kwon, Chief Financial Officer, Unilever Canada

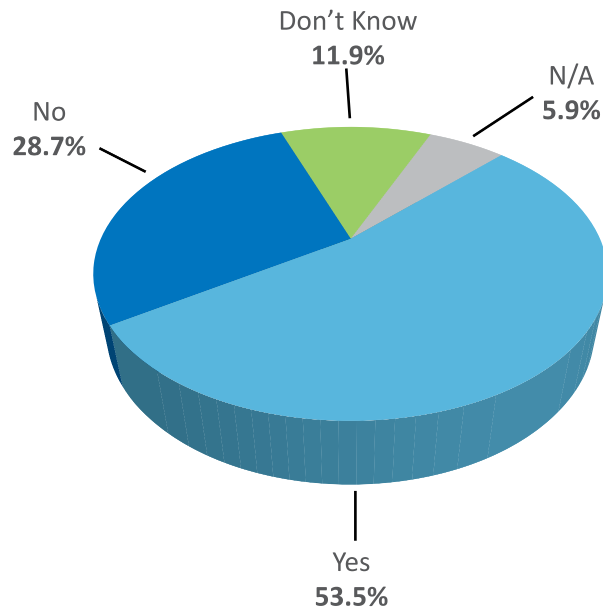
Senior finance executives will be even busier next year, with additional responsibilities for monitoring risk than in the past. Most executives said they planned to add more risk reporting. But relatively few said they were allocating new resources towards the task.

Having learned from the turbulence of 2009, companies are more focused on maintaining a closer eye on the potential risks to growth and profitability in 2010.

More than half (53.5%), said they planned to add more risk reporting as well as new processes for mitigating risk. However, most companies will be doing more with roughly the same budgets over the coming months, which will mean senior finance executives will get even busier.

The majority of companies, while wanting to improve their ability to mitigate some of the risks they've seen during the course of 2009, aren't prepared to add more resources to the effort. For example, 69.3% said they didn't plan to increase their spending on external consultants; 68.3% said they did not plan to hire people into risk management roles; and finally, over half (53.7%) didn't expect to be spending any more on risk management technology.

WILL YOUR COMPANY ADD MORE RISK REPORTING TO MITIGATE RISK IN 2010?



Conclusion

The results of this study support the view that the economy will return to normal growth rates in the second half of 2010. However, exporters are waiting anxiously to see where the Canadian dollar will go, in hopes the further increases will not choke off export demand. At the same time, companies are counting on renewed consumer confidence to stimulate demand in the coming months.

Many Canadian companies will be well positioned to capitalize on improved demand conditions in 2010. Mergers and acquisitions will be one strategy for increasing revenues and gaining efficiencies; however, companies will also be focusing on new investments in customer service and other productivity improving technologies.

We have also learned that senior finance executives across the country will continue to focus on cash and cost management in 2010, while public company CFOs will be knee deep in their IFRS conversion projects. They will also step up risk reporting, and potentially experiment with forecasting models that are more predictive of net income volatility.

Looking forward, a majority of executives were also positive about their own company's growth prospects. Overall, the majority said they believed there would be an increase in company revenue in 2010, while about the same number thought sales volume would increase. In fact, most respondents thought their company had improved its performance in 2009: nearly 70% said their own company was doing the same or better in the fall of 2009 than at the same time the year before.

To achieve revenue growth, the need to adapt client and consumer trends, as well as other rapidly changing conditions, was a theme echoed by a number of executives. Many executives spoke of the need to respond to changes in customer behavior by either leveraging brand awareness to increase market share, or targeting consumers looking for better price points.

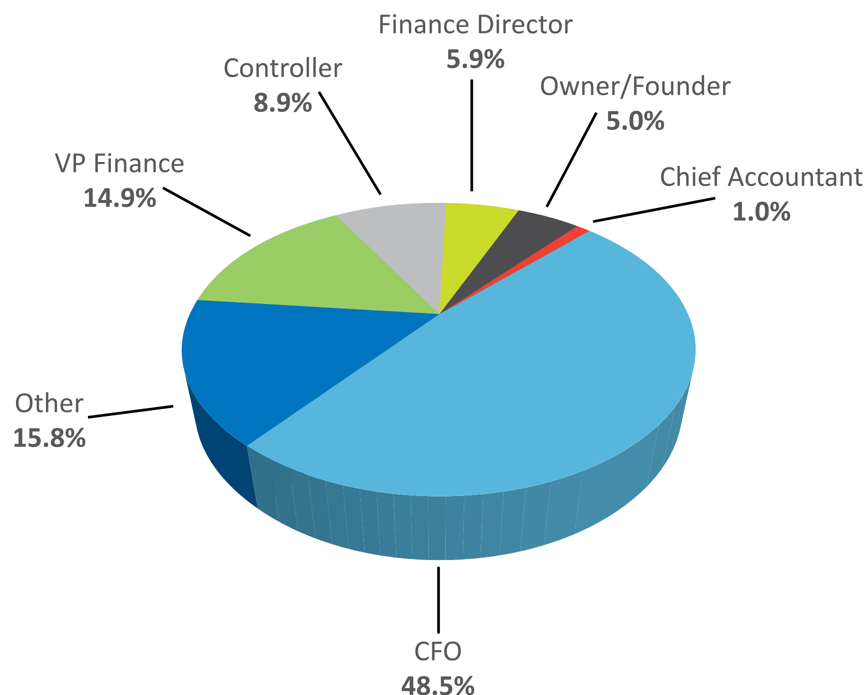
Overall, most companies will have enough capital in 2010 to meet regulatory requirements, shareholder expectations, and make the necessary investments to capture the opportunities of the forecasted recovery of the Canadian economy.

Appendix A: Survey Demographics

The majority of survey respondents were senior financial executives from companies with revenues of less than $250 million and most were located in Ontario, British Columbia and Alberta. Roughly half of respondents held the position of CFO. Relatively more private than public companies are represented in this sample, and the vast majority (81.9%) reported Canada as being their primary market. However, a large proportion of the companies in our sample (37.6%) were also highly dependent on exporting to the US. The top three sectors represented are financial services; manufacturing, and professional, scientific and technical services.

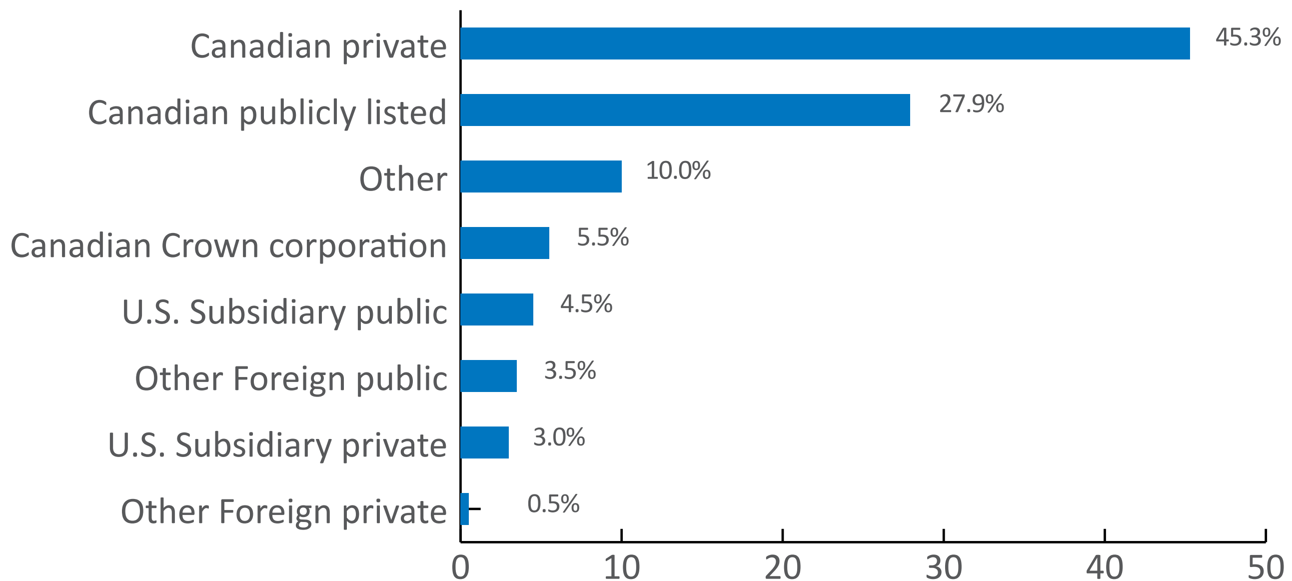
POSITION TITLE

A total of 202 surveys were completed by finance executives. Nearly half (48.5%) were CFOs, while 14.9% were Vice President of Finance; 8.9% were Controllers; 5.9% were Directors of Finance; 5% were Owner/Founders; and 1% were Chief Accountants. The remaining 15.8% held other titles or positions.



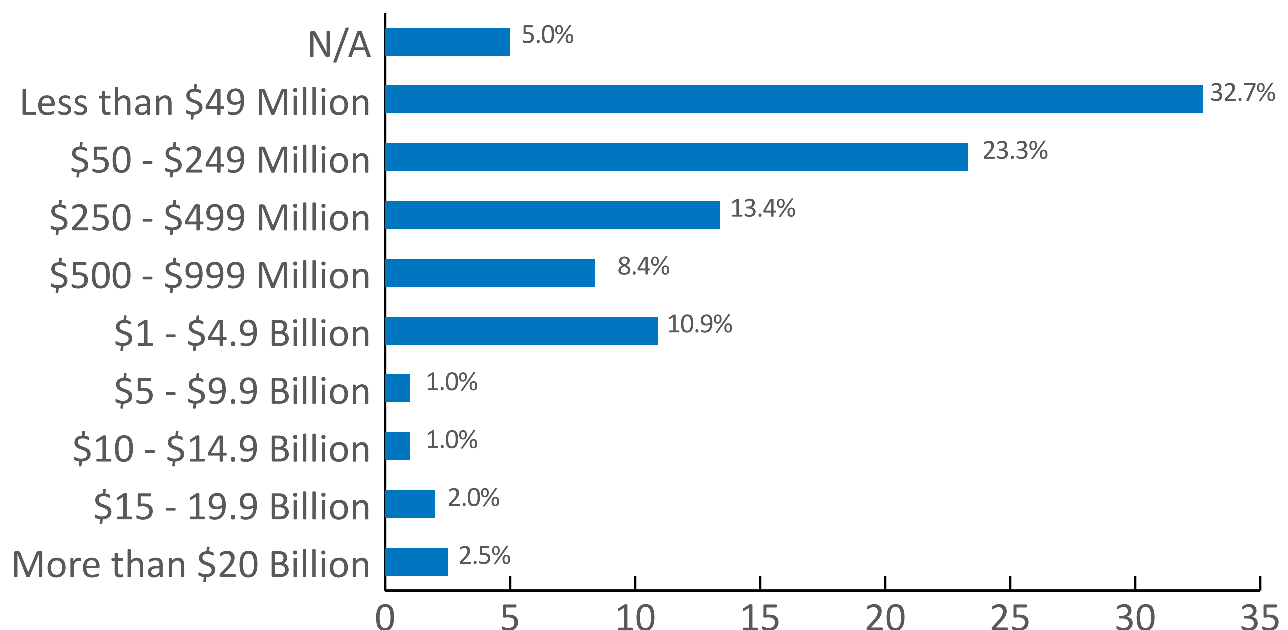
COMPANY STRUCTURE

45.3% of respondents were from privately-held Canadian corporations, while 27.9% were from publicly-listed Canadian enterprises. The remainder represented Crown corporations and U.S./foreign subsidiaries, both public and private.



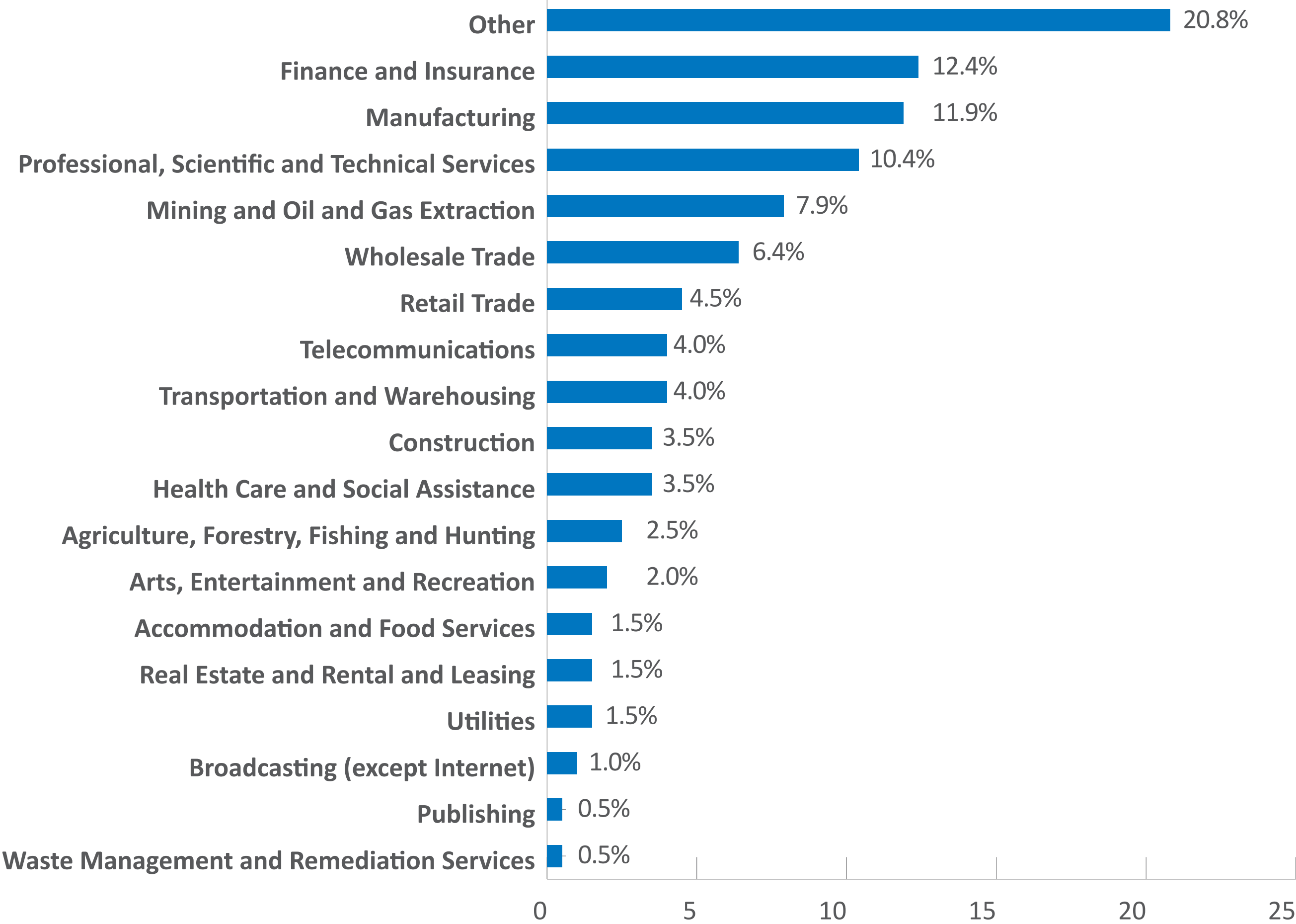
ANNUAL REVENUE

Most respondents were from small and medium-sized enterprises, as 56% reported their revenues to be less than $250 million. 21.8% had revenues between $250 million and $1 billion. The largest companies having revenues of over $1 billion represented 17.4% of the sample.



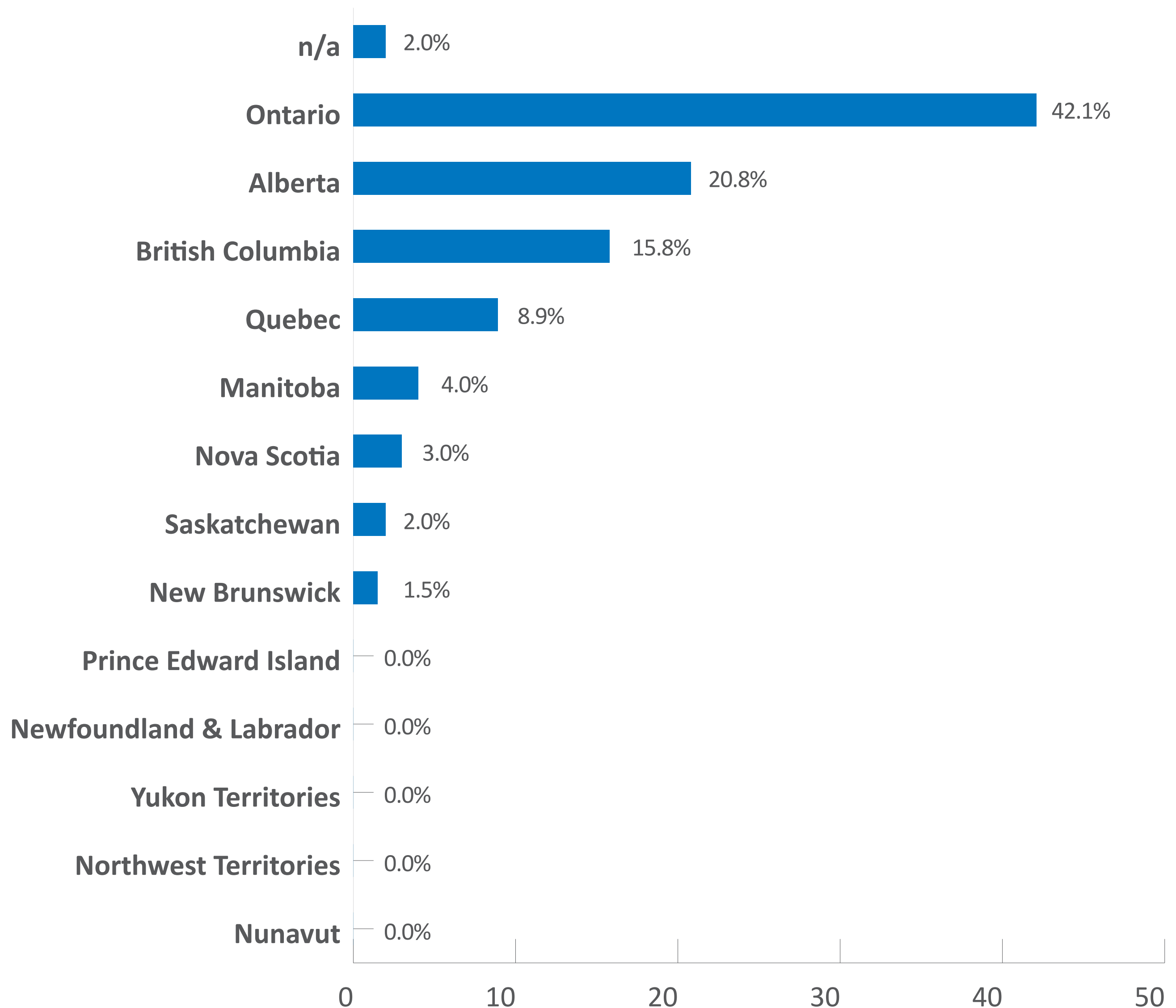
INDUSTRY GROUP

Respondents were also asked to categorize themselves according to 20 large Standard Industrial Classification (SIC) groupings.



LOCATION OF COMPANY HEADQUARTERS

The largest number of companies were headquartered in Ontario (42.1%), followed by Alberta (20.8%), B.C. (15.8%), Quebec (8.9%), Manitoba (4%), Nova Scotia (3%), Saskatchewan (2%), and New Brunswick (1.5%).



PRIMARY MARKETS

Canada was the primary market for the vast majority of respondents, (89.1%) followed by the US at 37.6%. Europe was also a primary market for 14.4% of companies, compared to China at 7.4%, South America at 5.9% and India at 5%.

Appendix B: Forum Participants

Forum Chair:	Michael Conway – Chief Executive and National President, FEI Canada
Moderators:	Ramona Dzinkowski – Executive Director, CFERF Irene David – Managing Partner, Greater Toronto Area, Ernst & Young
Special Presentation:	Timothy Lane – Deputy Governor, Bank of Canada
Participants:	Kriss Bush – Vice President, RBC Dominion Securities Kent Carson – Vice President, Finance, Holcim Canada Robert Clarke – Chief Financial Officer, British Columbia Ferry Services Inc. Tom Evans – Chief Agent, GE Employers Reassurance Corp. Carl Gauvreau – Chief Financial Officer, Hartco Inc. Bobby Kwon – Chief Financial Officer, Unilever Canada Harald Ladewig – Vice President & Treasurer, Honda Canada Finance Inc. William Robson – President, CD Howe Institute Greg Scott – Chief Financial Officer, Maple Lodge Farms Ltd. Francois Vimard – Chief Financial Officer, Sobeys Inc. Tim Zahavich – Chief Financial Officer, St. Joseph Communications
FEI Canada:	Laura Bobak – Senior Writer, CFERF Melissa Gibson – Research and Communications Coordinator, FEI Canada

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