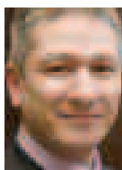
# ACT debate hits Yorkshire



**PETER MATZA** REPORTS ON THE HIGHLIGHTS OF THE ACT'S NORTH OF ENGLAND REGIONAL GROUP INAUGURAL CONFERENCE.

The first presenter was **Andrew Foulkes**, Group Treasurer of packaging and materials handling company Linpac Group, which has a turnover of around £1.2bn. Foulkes plunged us into private equity, leveraged buy-outs (LBOs) and hugely onerous syndicated loan and private equity investment agreements.

Having explained some of the principles behind LBOs and the mysterious world of private equity, Foulkes outlined the enormously detailed constraints that his treasury team worked under, both in relation to his banking syndicate of 35 banks (which funded the LBO) and the private equity owners. In particular, the meaning of the phrase 'cash is king' is clear in all aspects of Linpac's operations.

For Foulkes, meeting the timetable of treasury reporting and covenant compliance is a critical element in maintaining the balance between the operations of the business and the loan documentation/ equity investment agreement. Foulkes stressed that treasury benefits were apparent from the LBO – for example, a commercial discipline in the business (focused on cash) as well as not having to follow IFRS accounting rules. In pointing out that roughly 20% of the private workforce in the UK work or have worked for a private equity-owned business, he was keen to emphasise that treasurers have a critical role to play in ensuring the success of these transactions.

**Greg Croydon** from IMI followed with a careful talk on currency management. IMI is a UK-based global engineering business with a turnover in excess of £1.5bn.

Croydon took us back to the basic elements of currency risk management – transaction, translation and economic – and demonstrated how these classic principles are best seen as overlapping circles – for example, the impact on exposure of dividends moving from a balance sheet item to an actual cash payment. He advised treasurers to be aware of all elements of risk management as the value of a currency movement can differ markedly and expensively from the cash that appears in the bank account! Croydon outlined the necessary creation of a risk policy and then the implementation of effective and practical hedging techniques, including 'natural' or offsetting hedges wherever possible, such as matching production costs with the currency of sales.

**David Cleary** from Lloyds TSB finished the first session with a market overview of the syndicated loan and the US private placement markets. Cleary's view was that for investment-grade corporates, the banking market continued to offer tremendous liquidity, strong competition from the banks for mandates and relaxed covenant packages – much to the chagrin of the private equity-owned corporates in the room! But he was not so sure about pricing, and suggested we may be at the bottom of the cycle with fees on a gentle upward trend following heavy recent merger and acquisition activity. Of great interest was the stunning statistic that institutional investors now comprise around 45% of lenders in the leveraged loan market, up from only 5% three years before. As a banker Cleary was pleased that the increases in borrower leverage had not so far resulted in higher default rates – despite the high price of oil, rising short-term interest rates and demands for double-digit investment yields from these investors.


## Executive summary

- **The ACT's North of England Regional Group held its inaugural conference and networking event in November in Ainley Top, Huddersfield. The half-day forum was supported by Lloyds TSB and attracted a wide range of corporate treasurers, finance managers, competing bankers and an evidently ahead-of-the-game headhunter. The event was joint-chaired by specialist treasury consultant Graham Bond and Ian Leece, Group Treasurer, Kelda Group, joint organisers of the ACT's Yorkshire and Humberside Regional Group.**


In Cleary's view, the US private placement market continues to offer attractive funding for all types of borrowers, especially those with modest investment-grade status. He gave the example of a BBB- borrower accessing 10-year funds from US investors at cheaper rates than from a five-year UK bank loan. The attractiveness of the pricing and tenor is compounded by covenant flexibility, greater investor appreciation of 'UK plc', more secondary market flexibility and – of no little interest – competition between banks to be lead managers, thus ensuring fees remained keen.

**Gary Slawther**, Group Treasurer of Jarvis, then told us the story of how Jarvis had fallen so quickly and how long it would take to bring it back to full health. In the early 2000s, contractor Jarvis had moved into developing and operating facilities (such as the London Tubelines consortium) with an aggressive, debt-financed growth strategy, rather than traditional, tendered construction. Although Slawther only joined Jarvis in summer 2005, his choc-a-bloc tenure produced a fascinating and gripping story.

Briefly, Jarvis's public problems started with the rail crash at Potters Bar and its aftermath. In financial terms Slawther identified the internal failing at Jarvis as "profits not turning into cash", but this hid a raft of commercial and operational difficulties which precipitated a downward spiral. Jarvis came close to being closed. At that point, Jarvis was not trusted by its clients; it lacked credibility with its investors and lenders, and its businesses were subject to continual financial and operational audit. In particular, Slawther warned about distressed debt investors whose business oversight

pervaded all aspects of Jarvis's daily life. Slawther's advice was:

- Understand the critical importance of loan documentation and investor agreements;
- Be thoroughly prepared for every negotiation;
- Get the best external advice that you can afford – but be prepared to make your own decisions; and
- Every individual in the business must understand the implications of everything they do.

The theme of companies confronting serious financial problems continued with a presentation from **Andrew Koss**, Treasurer of Drax Power. A £3bn power-generation business, Drax became a lender-owned operation in late 2003 after the bankruptcy of its major customer, TXU Europe. Following a hurried financial restructuring in December 2003, Drax announced plans in 2005 to explore a refinancing and public listing.

Koss talked through the highly complex pre-existing financial structure where the fundamental aim had been to maximise shareholder value consistent with meeting debt obligations in full. However, Drax was inhibited in pursuing a wider corporate strategy by its financing arrangements; these became increasingly unhelpful given the changes in the energy and commodity markets, such as the introduction of carbon trading.

The March 2005 proposals were intended to more closely align the capital structure with the business. In particular, Drax wanted to ensure investment-grade credit status to enhance its trading operations, provide equity market confidence, work with more flexible covenants, and ensure investor diversity for its debt issues.

During the public listing process Drax was subject to three private equity bids which ultimately did not meet the board's requirements. Koss said that the 'noise' around the bids was unsettling to potential equity and debt investors, credit rating agencies and Drax's lenders. However, the initial public offer was very successful and Drax became a member of the FTSE 100 in June 2006 with a typical institutional shareholder base.

The final session of the morning was a **panel discussion** involving Croydon, Koss and Mark Elliott from Lloyds TSB's structured solutions team, and facilitated by Lloyds TSB's Sandy Sanderson. The panel considered a range of issues including IAS concerns, loan documentation and the impact of pension deficits.

- The view on pensions was that the current accounting position is too inflexible and should be adjusted to reflect the complexity of liability funding.

- On foreign exchange (FX) risk, it was accepted that SMEs had less tolerance for risk but that larger corporates were more comfortable passing FX volatility through their balance sheets. In particular, it investors have become much better at understanding financial risk, hedging practices and the relevant accounting treatment.

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