The treasurer is king

TALKING TREASURY, THE THIRD IN OUR THOUGHT-LEADERSHIP SERIES, WAS HELD IN DUSSELDORF IN THE SUMMER, ORGANISED BY THE ACT AND VDT AND SPONSORED BY JPMORGAN ASSET MANAGEMENT. **PETER WILLIAMS** REPORTS ON WHAT WAS ON THE MINDS OF EUROPE'S CORPORATE TREASURERS.

Private equity is still growing on a global basis at a tremendous rate and is an alternative asset class that is here to stay, according to Thomas Spinner, Investment Director of Advent International. At the Talking Treasury event, Spinner said that a third of all global merger and acquisition (M&A) transactions were financed by private equity.

The other trend is for private equity deals to get bigger, most noticeably in the US, where $1bn+ deals are becoming the norm. In the last four years US private equity deals are estimated to have grown eight times to hit $1.3bn on average, whereas in the EU the average deal size over the same period has grown three times to $500m. Spinner said another trend was the public to private transaction, which he described as a "day-to-day" phenomenon in the US.

Globally, private equity has raised the amazing figure of £500bn this year alone. Commenting on the leveraged nature of many private equity transactions, Spinner said: "Thirsty banks are looking at ever-increasing debt packages, with covenant-lite structures and seven to eight times earnings before interest, taxes, depreciation and amortisation (EBITDA) for senior loans becoming the norm."

One of the reasons why private equity has worked is the reduction in credit default rates. Spinner claimed that the capital structures and purchase multiples were becoming a global phenomenon covering Japan, India and central Europe, as well as the US and western Europe.

Spinner encouraged companies and treasurers to talk to private equity firms and said that as cash was more king than ever, so the treasurer was also king, a sought-after species as a guarantor of a decent return. He added: "You can go after private equity or it will find you. It is up to you how you want to play it. It is normal for financial professionals to have their private equity firm of choice."

Richard James (pictured), the Deputy Chief Executive Officer of the ACT, who chaired the session, said high-profile fears over private equity had overshadowed its success. He said concern had been aroused by the wealth of the private equity managers, the vocal opposition of trade unions to asset stripping, significant restructuring, and deals involving household-name companies. There is also concern over the credit cycle turning and the implications for highly leveraged deals.

James said: "One could comfortably argue that private equity is doing what incumbent management should have done but for some reason felt they were unable to do in public ownership." He added that as an ex-treasurer he found private equity's "obsession" with cashflow as "very positive" and a sharp contrast with equity analysts' focus on earnings. "Given that treasurers are the owners of capital structures and cash management – two of the critical elements of success of private equity – they can bring understanding of the tools to help their companies emulate the success of private equity."

On the panel were two treasurers with first-hand experience of private equity. During the panel discussion, Andrew Foulkes, Group Treasurer of Linpac, said: "There has been an element of what will return short-term benefits. Longer-term investment projects would have to really prove themselves in the analysis phase to get the acceptance now that they would have received when it was a family company. When Linpac was a family company there was plenty of time, and the idea was to grow the business over time. Now we have an exit coming up at some point, and there is a focus on that. But there is an emphasis on what the investment will do to the exit value and how a potential investor will assess the value it is adding."

The other panellist, Jan Maarten Ingen Housz, Group Treasurer of NXP Semiconductors, said that when the sell-off of the division from Philips was announced, people started knocking on the door, including private equity. He said: "At first the climate within the company was: private equity – never. They were the barbarians at the gate who would destroy the business – cut it into small pieces to maximise value in a short period of time. But we learnt a lot in the process. It became clear private equity was a partner focused on long-term value creation."

PENSION MANAGEMENT AND MEASUREMENT Across Europe pension management is moving to focus on underlying economics. Regulators, shareholders, boards, pension beneficiaries and consultants to the industry are becoming more sophisticated and economically focused, according to Guy Coughlan, Head of Pension Asset-Liability Management (ALM) at JPMorgan. Defined benefit pension plans still represent the biggest challenge for boards because of their impact on corporate balance sheets, risk management and capital structure.

The legal status of a pension promise has evolved over time and is different in different countries. In the UK it used to be a signal of intent, now it is a cast-iron obligation. This has changed the cost of the pension promise and the pension has become more debt-like.

But there is still no agreement on how to cost pensions. A common way is evolving, but we are not there yet. Coughlan said: "There is a degree to which many corporate sponsors and/or beneficiaries cannot share in the surplus which may be generated in a pension plan if assets exceed liabilities. To the degree surpluses cannot be shared that gives pensions an option-like characteristic. That option is never valued."

Reg Hinkley, Chief Executive Officer of BP Pensions Trustees, said corporate treasury was a good place to think about pensions. He said: "The skills of treasury management are highly relevant to pensions. There are broader financial issues – basics such as cash management and risk management – especially the complex issues of managing and valuing risk."

Hinkley said increasing longevity meant people were being supported by a former employer for up to 40 years after leaving the company. He said: "If we started with a blank piece of paper would any of us write such a contract now? Of course not." He said valuation was important because it set the context for the pension debate.

Verena Volpert, Senior Vice President Finance at E.ON, gave an overview of the events in the German system. She said that despite perceptions to the contrary, the German system was not too bad. She said: "In Germany we have a system that protects the pensioner.

All German employers share the burden in case companies go bust."

Volpert said there were no cases where pensioners had lost money, but suggested the system might be tested in the coming decades because it was costing corporates so much. Despite this, the benefits in Germany appear lower than the UK, so pensioners have to rely on the state pension, which is higher than in the UK. In Germany, the benefits are normally based on a book reserve scheme, which amounts to a promise by the employer to the employee. Germany has also undergone a rethink on the way of looking at different pension obligations and is looking at indebtedness in different ways.

THE RISK MANAGEMENT CHALLENGE Three treasurers from around Europe gave their views on the risk management challenge facing the profession. Brendan Boucher, Group Treasurer of OMV, said: "Only a consistent, comprehensive and fully integrated all-risk evaluating risk management system provides the solid basis." He said that the solution was enterprise-wide risk management.

Dirk Kirsten, Group Treasurer of Swiss-based global agribusiness Syngenta, said that his company's above-average growth was only possible within balanced risk-taking/mitigation approach. Syngenta has a seasonal business model with emerging markets of rising importance to the company, which creates different risks.

Kirsten examined some of the risks which his company took and the risk mitigation methods which had been adopted. He gave an example of the integrated customer risk management the company tried to adopt. The Latam soybean is dependent on dollar-based pricing. The foreign exchange (FX)/commodity price created margin risk and credit risk. Many of Syngenta's customers are not able to hedge their exposure and often lack balance sheet strength. By offering FX and commodity hedging for customers, Syngenta is able to share potential upside and support above-average growth by managing the higher counterparty risk.

The session was chaired by Greg Croydon, Group Treasurer of UK-based multinational engineering company IMI. He asked treasurers to think what benefits their companies were receiving from risk management. He described risk management as a task that treasurers did by instinct. He said: "If there is a minor risk which is easy to hedge, easy to reduce the volatility on, then why not do it? However, if there is a risk that you cannot do anything about, or a risk which your shareholder does not expect you to do anything about, then why waste your time on it?"

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