TREASURERS **LUCY FULLER** OF SMITH & NEPHEW, **BOB WILLIAMS** OF ALLIED DOMECQ AND **PIERS WILLIAMSON** OF THE HOUSING FINANCE CORPORATION GIVE THEIR VIEWS ON THE ECONOMIC OUTLOOK FOR THE YEAR AHEAD.

THE TREASURY ISSUES THAT MATTER FOR 2004

LUCY FULLER
GROUP TREASURER, SMITH & NEPHEW

The market as a whole was quiet at the beginning of the year but the banks liked our deal, I think, because we are seen as a good credit. The markets respond favourably towards companies that can demonstrate strong stable performance and we benefited from close strong relationships with our bank group.

My feeling is that the bank market has picked up as the year has gone on – banks have the capacity for the deals in which they want to be involved. In general, we have found the economic conditions in 2003 to be better than in 2002, but not in every country. The US is our major market and we have seen strong demand there. We do not have the same concerns about the US market that some other companies seem to have – many of our products are used for sporting injuries and for the ageing population, so lifestyle changes and demographics are working in our favour and there is good demand for our innovative and differentiated technologies. We have a strong position in the US and have seen organic, double-digit growth. I believe the US economy will continue to improve.

I also feel generally positive about conditions in the UK. The interest rate rise was not a particular concern for us because we hedge our major exposures at least 12 months in advance and, overall, our debt is low, so there is no significant interest rate risk.

As for 2004, I do not see any immediate changes in the treasury markets. We do not have any concerns about the availability of bank finance. We are not in the capital markets, but there is a lot of investor appetite out there.

One of the biggest issues for treasurers in 2004 will be the implementation of IAS 39. I have concerns about the practical implications of the standard, especially for smaller companies, and I do not believe that accounting standards should affect economic decisions.

Smith & Nephew, the medical devices company, trades in more than 90 countries around the world. It is quoted on the London Stock Exchange (as a FTSE 100 company) and on the New York Stock Exchange and reported sales of £1,110m ($1,676m) in 2002. During 2003, the company launched a bid for Centerpulse, the Swiss medical technology group, and InCentive Capital, an investment company and Centerpulse's major shareholder. The offer later expired after Zimmer, a US orthopaedic company, made a higher counterbid.

Smith & Nephew put in a bid for Centerpulse in March 2003 and went through many of the planning processes before Zimmer launched its bid. We arranged an underwritten, committed bank facility finance of $2.1bn, which was later syndicated. The bid was announced on the day the US and the UK declared the war with Iraq but, despite the uncertainties, raising the money turned out to be straightforward. Our arranging banks were very supportive and we achieved good pricing and terms.

smith&nephew

BOB WILLIAMS
GROUP TREASURER, ALLIED DOMECQ

Allied Domecq, the wines, spirits and quick service restaurants group that counts Beefeater gin, Tia Maria and Dunkin' Donuts among its brands, announced a 2% growth in turnover to £3,410m for the year to 31 August 2003. Profit before tax for the year rose by 3% to £495m and net cashflow from operating activities increased by 26% to £702m. Chief Executive Philip Bowman said at the results announcement that the group's underlying profits, excluding pension costs and foreign exchange (FX) grew by 20% during the year.

During 2003, we completed the integration of a number of businesses that we have acquired. As far as treasury is concerned, we refinanced our £1bn revolving credit facility, with a £1.1bn fiver year facility which went extremely well. In terms of covenant package and terms, the deal lived up to our expectations.

We have now removed the refinancing risk for the group. It has been a solid year for us and we feel the markets and banks have been there for us. I think that is down to our sector and our business – the market sees that we are a credible company.

My feeling is that the markets are getting better, maybe not up to the standards of three or four years ago, but there are encouraging signs, such as the fact that banks are willing to support good corporates. I would say that many of the banks are being more choosy, but the markets in general are working through the problems of the last few years.

As for 2004, my feeling is that conditions will continue to improve, although the markets will remain cautious. The problem often is that markets tend to over-react at the slightest hint of good news – in the equities market, for instance.

As for Allied Domecq, at our results announcement we said that the conversion of profits into cash would continue to be one of the group's main priorities and we delivered in that area this year. We have the foundations in place for the coming 12 months.

PIERS WILLIAMSON
CHIEF EXECUTIVE, THE HOUSING FINANCE CORPORATION

Piers Williamson, a former bank treasurer, is chief executive of The Housing Finance Corporation (THFC), a not-for-profit organisation that makes loans to registered social landlords (such as housing associations), which provide affordable housing to tenants across the UK. THFC acts as an aggregating financial intermediary in the process, diversifying risk for those who make funds available to it and reducing the cost and standardising the loan terms for registered social landlords that borrow from it. THFC itself raises money in the UK bond markets and from banks, and currently has £2.1bn of loans, including £0.6bn of third party loans, under management.

One of my performance barometers of the UK economy is the appointments section of the *Financial Times*. Although it is focused on the finance sector and the City in particular, in the past few months it has seen a significant shift in the make-up of the advertisements, which is potentially indicative of employment trends more generally. The City of London is still comatose, but the number of not-for-profit/quango appointments appearing in the newspaper is significant. This year has seen a significant rise in public sector investment and in public sector employment, and the growth in that sector has had wider implications for the economy.

Many economic commentators are indicating they believe the Treasury's general growth forecasts continue to be unduly optimistic. The green shoots are only just beginning to come through. It will be interesting to see whether the current wave of investment can be translated into measurable output in this Parliament. Currently, the markets have given the Treasury the benefit of the doubt and, as a consequence, longer-term sterling interest rates have not picked up significantly.

The death of inflation debate has been on and off the cards all year. The residential housing market has two distinct views: the 'doom and gloom' view, which roughly corresponds to a 20% correction in the market, and the view that demand for housing will outstrip supply, which means house prices will be maintained, or even increase. Principally driven by demographic trends (longer life expectancy and growth in absolute numbers of discrete household units), we see fundamental longer-term demand for social housing as buoyant.

At the moment, our sector cannot produce housing fast enough. Balanced against that, in the residential mortgage sector, there is significant consumer gearing, coupled with high interest rate sensitivity.

Everyone is focusing on consumer spending at the moment. We have started, quite rightly, to see a correction there. There is still a high penetration of floating rate mortgages and, consequently, consumers are very sensitive to interest rate rises as a result. Because additional gearing has been incurred at current low interest rates, a 1% or 1.5% rise or more in interest rates could have a significant adverse cashflow impact on consumers.

As far as my sector is concerned, there could be a knock-on effect from a correction in the residential mortgage sector, not next year but perhaps in 2005. From an overall borrowing perspective, social housing is a rich seam and the Treasury is demanding more and more. The big push is certainly on for Private Finance Initiative (PFI) and the flavour of the month is currently ALMOs, a sector half-way house, where local councils can achieve some of the benefits of the PFI culture, but on balance sheet. The transfer of council housing to the housing association sector as a trend is slowing down because transactions, primarily for inner city stock transfers, are becoming more difficult to structure.

'Despite the public backlash against foundation hospitals, pressures on the public purse mean that the Treasury still has PFI high on its agenda for delivery, hence the continued growth of PFI-related finance teams in the City. It is also rewarding to see more and more trained treasurers coming into positions in housing associations.

Overall, I am more optimistic about 2004 than I was about 2003. The underlying economics are enormously challenging, but in a positive sense. If there are clouds on the horizon, they are a serious correction in the residential mortgage sector, perhaps combined with a perception in the City that investment in public services might be translated into old-fashioned cost-push inflation. From our point of view, it is important that we can build our reputation as a best-in-class social enterprise. There are enormous challenges out there and I am sure that the demands from government will become even more stringent in the lead up to the General Election.