The cash conundrum

BLOATED BALANCE SHEETS DON'T APPEAL TO BUSINESSES, BUT NEITHER DOES NOT PAYING THE BILLS. FARAH KHALIQUE EXPLORES THE LIKELIHOOD OF CORPORATES BECOMING SPENDERS, NOT SAVERS

Corporate treasurers are committed to putting their companies' burgeoning cash piles to good use but, significantly, many still expect to hoard more than ever before. This was one of the key findings of the ACT's 2014 *Corporate Cash and Liquid Investments Survey*.

The ACT conducted the survey of company treasurers, mostly UK-based, in July and August 2014 to find out their plans for holdings of cash, with respondents coming from companies that ranged in turnover size from less than £25m to large corporations with annual revenues greater than £5bn. The findings, published in September, correlate with other research that shows corporate treasurers in the world's largest economies are stockpiling more cash then ever.

US non-financial companies rated by Moody's held $1.65 trillion in cash at the end of the second quarter of 2014, up from the previous record of $1.64 trillion, according to a research note published by the rating agency in October. The top five cash kings are Apple, Microsoft, Google, Cisco Systems and Oracle, which between them hold $415bn, or a quarter of the total corporate cash balance.

In the UK, it is estimated that private non-financial companies have held around £500bn in recent quarters, according to figures published in the UK National Accounts.

Time to spend?

While businesses have come under fire for not spending their cash, nearly three-quarters (72%) of those surveyed by the ACT said they plan to use their cash. Meanwhile, 6% believed their cash would run down naturally as the economy recovers. The main reasons treasurers gave as to why they would run down their cash include higher borrowing costs, greater access to committed borrowing facilities and sustained low or negative interest rates.

Treasurers who want to spend their cash also have the option to pay down debt, invest in R&D, or return it to shareholders through share repurchases or company projects such as new investment initiatives or M&As.

Matthew Norris, group treasury manager at oil and gas services group Petrofac, says that if a company can't use the cash beyond earning bank deposit rates, it should be returned to shareholders. "Holding excess cash is an inefficient use of resources and, left idle, destroys shareholder value," he notes.

"There is often pressure from shareholders to run down any large cash balances. Any logical shareholder would rather get their money back if it can't be invested within the company to add to shareholder value."

The key reason why Norris looks to reduce cash balances at Petrofac is because the company is in net debt, so any cash that is used to repay its debt saves the company from paying interest.

And in contrast to public perceptions that businesses are hoarding their cash, some are actually incredibly keen to part with their money. The ACT research found that almost a fifth of treasurers (18%) surveyed want to "aggressively" run down excess cash reserves.

Britain's largest power network, UK Power Networks, is one such company. According to its head of treasury, Andrew Kluth, it is in the camp of those that want to get rid of excess cash. His reasoning is that a high cash balance is inefficient and risky – borrowing in long-term markets at 3-5% and investing in banks at 0.5% costs money and runs the risk of credit exposure. For example, where a company has £3bn in cash that it has borrowed at 4% and it is investing at 0.5%, that costs £100m a year.

"I haven't seen anything that persuades me that a ballooning balance sheet makes any sense," he says.

UK Power Networks did a debt repurchase earlier this year to buy back £190m of debt, as part of its strategy to aggressively run down its cash.

"I think some companies do not understand how the treasury process works and how easy it is to borrow through capital markets or banks such as the European Investment Bank. Credit spreads have been declining for many years, and rates get cheaper and cheaper," says Kluth.

Strategic priorities

Companies with plenty of cash and no concerns about a potential rating downgrade can return cash to shareholders, through special dividends or share buybacks, and those that don't want to change their capital structure can repurchase debt.

But companies that are not seen as investment-grade and that struggle to borrow money may understandably want to hold more cash for safety reasons. Also, those firms in the fast-moving consumer goods sector experience more volatile cash flows, so it makes more sense for them to have a high cash balance.

But ultimately, cash should either be invested in the business or returned to shareholders, says Hamish Mansbridge, CEO of private equity-owned retail company Snow+Rock Group.

"Having cash on the balance sheet offers almost zero return. If your business is worth

WHAT DO TREASURY PROFESSIONALS THINK?

"Treasurers do not insist on high cash balances, but boards often do, to make sure they can sign off the business as a going concern. They might think [it] is a good insurance policy, but I disagree."
Andrew Kluth, head of treasury at UK Power Networks

"Central banks and regulators are saying the entire global economy can be managed and corporate treasurers are saying 'Gimme a break!' Central banks are actively distorting market rates."
Tony Carfang, partner and director at Treasury Strategies

"The biggest companies aren't being awkward or perverse or hoarding money for no good reason; they have good reasons."
John Grout, policy and technical director at the ACT

"I see more companies concerned about the banks, resulting in a preference to diversify into money market funds, liquidity funds and commercial paper. They are more worried about security and liquidity than yield."
Matthew Norris, group treasury manager at oil and gas services group Petrofac

its salt, it ought to generate a better return," he says.

To that end, Snow+Rock Group is reducing its cash balance to invest in new opportunities to drive the business forward, such as new stores, improvements to its website and customer services.

"With historically low interest rates, cash is generating no income, whereas one hopes that our own investments… will produce much higher returns," Mansbridge explains.

Meanwhile, companies that want to support their suppliers can use their excess cash to offer supply chain finance programmes, whereby they pay suppliers' invoices early in return for a fee.

Woodsford TradeBridge is a service provider that works with companies and their suppliers to set up early-payment programmes. It will often fund suppliers' invoices entirely by itself because corporate treasurers do not wish to use the company's cash balance, but this is changing.

Olivier Bonavero, co-founder and director of Woodsford TradeBridge, says that it increasingly deals with companies that are willing to set aside some money to pay their suppliers early.

"We will provide, say, 50% of the funding and the company will provide the other 50%," he says.

He partly attributes this to the economic recovery, particularly in certain sectors such as construction, which has positively benefited from the UK's housing boom. A large, public construction company may well use numerous small contractors. During a growth spurt, such contractors are inundated with offers from different construction companies and have a choice as to whom they wish to work for. Therefore, a construction company offering a solution to pay suppliers immediately has an obvious advantage.

"When sectors are going through sudden growth, the capacity to treat suppliers well can have a significant impact," says Bonavero.

Corporates' caution

The ACT's survey revealed that 43% of businesses foresee they will continue to hold higher levels of cash than they used to – 16% even have a formal policy on the matter. Despite the economic recovery afoot both in the US and the UK, it seems that treasurers are increasingly wary of negative data sentiment coming from the eurozone and the threat of deflation, says Nick Raich, CEO of The Earnings Scout, an independent economic research firm based in Cleveland, Ohio.

"CEOs who were ready to spend are apprehensive," he says. >

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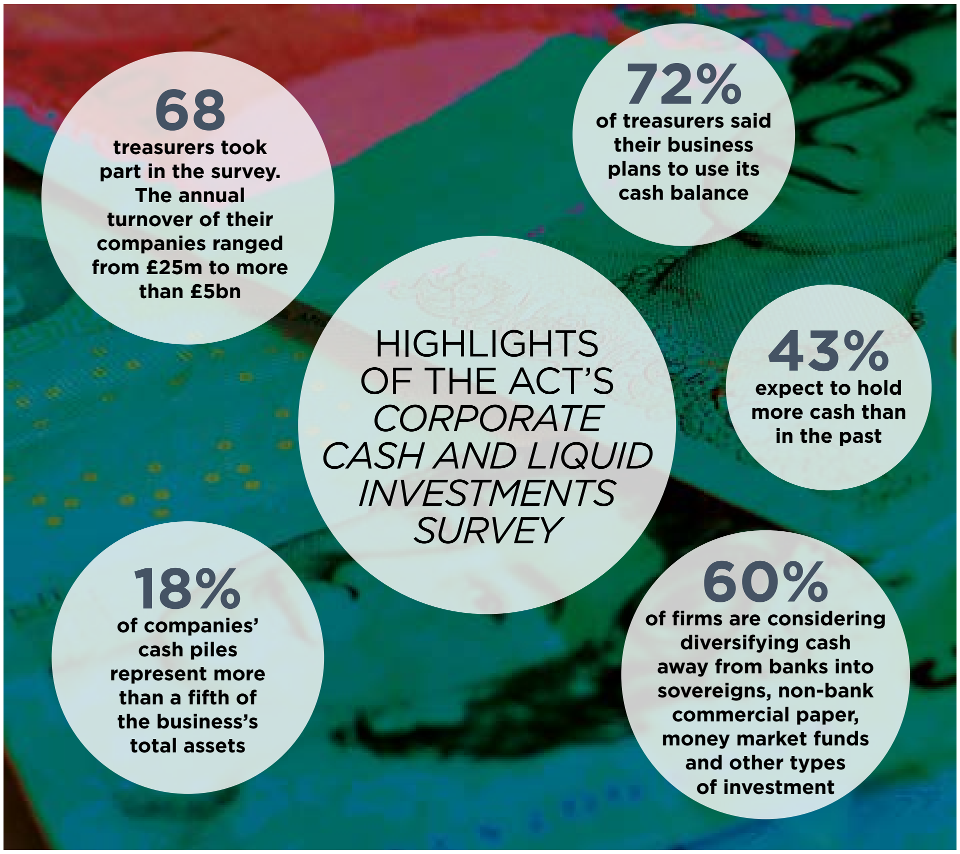

Volatility in financial markets has also created yet more uncertainty. The VIX Index, a measure of market fear, spiked to 26 points in October, from just eight points earlier that month, and after a sustained period of subdued volatility.

More than half the ACT's survey respondents (52.5%) said that increased political and economic uncertainty would prompt them to increase their cash holdings, while almost 40% pointed to continued regulation of banks that reduces their ability to lend.

Corporates are beginning to understand that regulations such as Basel III, which are focused on the banking system, will have a trickle effect on corporates, says Tony Carfang, partner and director at consulting firm Treasury Strategies.

"Banks will be less able to do things for corporates than in the past; one of those things is lending. [The regulation will] reduce banks' appetite to make corporate loans or [they will] increase the cost of the loan," he says.

The truth is that companies are still cautious about the state of the banking system and the expectation from authorities that larger companies rely more on capital markets than the bank to fund themselves, says John Grout, policy and technical director at the ACT.

"A feature of capital markets is that they aren't always open, and it can be more difficult sometimes to get bond issues away. Companies have taken the view that they should fill their boots while they can, even if that means holding more cash than they might choose normally," says Grout.

The ACT's advice to its members is to "fund early and fund long" when possible, and it has not changed that advice since it was first issued in 2006. Companies have taken note. Global bond issuance for the year to 22 October totalled $5.14 trillion, a slight increase from $5.10 trillion for the same period last year, according to data from information provider Dealogic.

Convince treasurers to spend

The only way corporate treasurers can be convinced by governments to spend cash is if they truly believe the economic recovery is authentic, says Carfang. Since the financial crisis, central banks have intervened to stimulate economies, but they are not publicly elected or accountable in the same way as politicians.

The president of the European Central Bank, Mario Draghi, announced in October that the central bank will spend €1 trillion buying covered bonds to kick-start the economy and stave off deflation.

"Now most corporate treasurers do not think markets are in equilibrium, [they are] going to hold their cash until that is achieved and then begin to deploy it. Once they believe the market is fairly pricing risk and credit spreads, then markets will start moving again," says Carfang.

As Raich predicts, CEOs need to believe the recovery is real and not artificially induced by central banks before they will actively spend and hire.

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