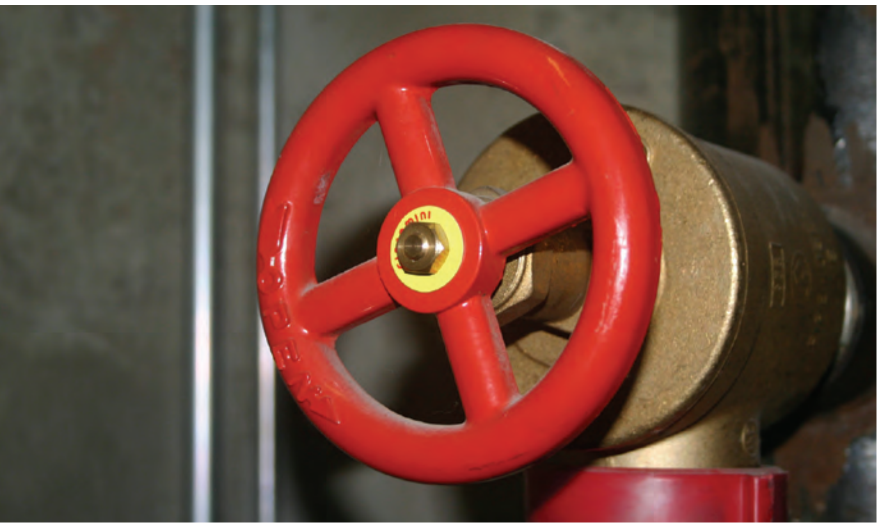
Optimising liquidity in a challenging market

TO MANAGE WORKING CAPITAL EFFECTIVELY, TREASURERS NEED TOOLS THAT WILL ALLOW THEM TO EXTRACT THE MOST LIQUIDITY FROM THE BALANCE SHEET, IDENTIFY AND MITIGATE RISK AND SUCCESSFULLY LEVERAGE THE COMPANY'S FINANCIAL AND NON-FINANCIAL ASSETS. FORTIS EXPLAINS.



Executive summary

Whatever the size of company, treasurers need to maintain adequate liquidity and ensure the health of the balance sheet, a responsibility which becomes more daunting in an increasingly turbulent and unpredictable market. There are various options available to treasurers to enhance liquidity, ranging from strategic, long-term initiatives to tactical, pragmatic changes with an immediate impact.

Treasurers and CFOs, with a diverse and challenging role at the best of times, are now under increasing pressure to source funds more cheaply and make capital work harder. Typically, working capital initiatives have focused on receivables (including payment terms offered to customers) and payables (payment terms to suppliers). In today's market however, the traditional ethos of "collect faster, pay slower" has evolved further as companies recognise the increasing risk of supplier and customer failure. To manage working capital effectively, treasurers need tools that will allow them to extract the most liquidity from the balance sheet, identify and mitigate risk (including supporting suppliers through supplier financing programmes) and successfully leverage the company's financial and non-financial assets.

INCREASE VISIBILITY It is vitally important to connect each point in the financial supply chain, across different areas within the business, with consistent data passed from suppliers at one end, through to customers at the other. As Peter van Ginneken, Director, Financial Supply Chain and Cash Management, Merchant Banking at Fortis explains:

"A key question treasurers and CFOs need to be able to answer is: 'Where is my cash at any point in time and why?' In reality, most companies only have a partial view, making it difficult or even impossible to identify opportunities to reduce working capital and leverage their assets more effectively. Companies are looking for solutions to achieve visibility into the financial supply chain, including both customers and suppliers. They need the same data throughout the chain, resulting in consistent management information, and to find ways to push out costs, not simply move them elsewhere in the chain."

Achieving this transparency is more difficult when financial functions such as treasury, payables and receivables are fragmented. This may be the result of rapid expansion or acquisitions in countries where the company's domestic bank does not have a presence. The result is often multiple banking relationships, managed by local business managers in each country, which can be a significant hindrance when trying to achieve a complete view of cash.

One way of addressing this is to move to a centralised cross-border cash management approach, working with a primary international banking partner.

Paul Cardoen, Managing Director of Commercial Banking at Fortis, emphasises the importance of working in close partnership with your relationship manager.

"By moving from multiple relationships to a single cross-border banking relationship, you are in a better position to negotiate favourable terms and benefit from more integrated solutions. At Fortis, our clients interface with a global relationship manager who oversees the entire client relationship and acts as the central point of contact and trusted adviser to the treasurer and CFO. Not only does this mean we are able to give better financial advice, but it is also

much more convenient for the treasurer as they avoid multiple communications and points of contact for different financial activities."

Tony Wonfor, Managing Director, Corporate Banking, Fortis Bank UK adds: "In recent months, we have noticed that our clients tend to consult us more – they use us as a sounding board, asking us to come up with innovative ways of dealing with the new challenges they face in the current climate."

INCREASE PREDICTABILITY Having enabled visibility over the company's working capital, the next step is to seek greater predictability of cashflow. If cashflow is highly volatile and the treasurer or CFO's ability to forecast effectively is limited, the company needs to maintain high levels of working capital to cover this uncertainty.

Tony Wonfor continues: "Working with a network bank also enables the treasurer and CFO to put domestic and cross-border cash management structures in place to pool cash, either physically or notionally, with the ability to maximise interest and offset positive and negative balances across the group, reducing the need to borrow. This is particularly important for multinational corporations operating in different countries and time zones."

Paul Cardoen illustrates the point. "Working with a bank that has a single electronic banking platform across the countries in which you do business may allow you to harness information from multiple locations. Information from the banking platform can then be integrated with internal systems to enable automated reconciliation, decision-making on short-term liquidity and cashflow forecasting. By reducing manual intervention, you also benefit from streamlined processes, reduced cost, and greater control."

REDUCE COST In an environment where growth of the business may not be possible in all markets, there are other ways of ensuring that the company remains successful. For example, by streamlining the physical and financial supply chain, profit margins can be increased without necessarily adding to the volume of business. Business managers, including treasurers, also need to look at the company critically to identify products, distribution channels, clients or technology which are consuming either cash or capital and make strategic decisions about whether these are core to the company's activities. Selling non-strategic assets or minority participation in joint ventures is also a way in which many companies have re-energised their balance sheets.

Five issues keeping CFOs awake at night

- Where's the cash sitting in the company today? And why?
- Can I increase the predictability of my cashflow?
- Can I continue to finance the business through credit facilities? What other assets could I leverage instead?
- Have I identified all the risks along the financial supply chain?
- Our growth has slowed this quarter but we need to invest. Will my bank continue to support me?

IT IS VITALLY IMPORTANT TO CONNECT EACH POINT IN THE FINANCIAL SUPPLY CHAIN ACROSS DIFFERENT AREAS WITHIN THE BUSINESS, WITH CONSISTENT DATA PASSED FROM SUPPLIERS AT ONE END THROUGH TO CUSTOMERS AT THE OTHER.

MANAGE RISK In addition to improving processes, managing risk in the working capital cycle is a key consideration. After all, a firm may have exceptionally efficient processes but any potential benefits fall away if a major customer goes bankrupt with large invoices unpaid. Tim Corbett, Managing Director of Commercial Finance at Fortis Bank UK, emphasises:

"A vital form of risk protection for any company is credit protection against the sales ledger. This simple safeguard is easily forgotten… until a major customer goes bankrupt. The decline of consumer confidence has had an impact on spending, and consequently we have seen some retail failures. This has hurt many manufacturers and suppliers."

LEVERAGE ASSETS Many companies are seeking to rebalance their business activities to take advantage of stronger growth in other markets. With credit less readily available than in previous years, what should a treasurer or CFO be doing? Tim Corbett continues: "During periods of economic uncertainty, the least attractive debt from a bank's point of view is an unsecured loan. However, if a company uses its assets, such as receivables, stock, machinery or property as part of a working capital facility, the bank will often be far more willing to support its financing requirements. Looking forward, there is a time lag in companies' ability to attract finance, even when a business is expanding. Earlier periods of slower growth or stagnation will influence banks' credit decisions and potentially restrict a company's access to funding. We are seeing continued year-on-year growth in asset-backed financing and an increase in the size of companies looking to use these mechanisms."

REDUCING THE COST OF DEBT Another factor when looking at the financing issues and management of risk is to look at the cost of debt, such as the mix of fixed and floating rate debt. Tim J Kirkham, Executive Director, Head of UK Corporate Sales at Fortis Bank UK, says:"With such a significant discrepancy between UK base rates and 3 month Libor, interest payments on floating rate debt remain high despite the recent fall in official rates. Typically, companies use interest rate swaps or options to hedge their underlying debt, but the difference between base and Libor rates makes this more complex. However, it can be turned to companies' advantage by using interest rate swaps to actually hedge against the credit crunch as the forward Libor curve would

COMPANIES NEED TO SPEND MORE TIME ON PEER BENCHMARKING TO IDENTIFY COURSES OF ACTION WHICH COULD ENHANCE THEIR COMPETITIVE POSITION AND MARKET PERCEPTION.

seem to be under-predicting the likely credit constrained environment in the next two to three years."

Many companies are still trying to borrow against base rate and have concerns about using 3 month Libor as a benchmark as a result of recent market activity.

SEEKING A WAY FORWARD Finally, Tony Wonfor, Managing Director, Corporate & Public Banking, Fortis Bank UK, summarises why treasurers and CFOs should be prioritising these issues today:

"With liquidity and credit issues affecting the availability and terms of funding, companies are now advised to reconsider all available options and to some extent go 'back to basics'. Working capital optimisation and financial supply chain management have been discussed at length by treasurers but with many companies now forced to move away from their reliance on financing, now is the time to put these initiatives into practice.

Companies need to spend more time on peer benchmarking to identify courses of action which could enhance their competitive position and market perception. This could be addressing a pensions deficit, vendor financing or receivables centralisation, but many of these financial initiatives bring both tactical and strategic value. The better the treasurer's and CFO's understanding of shareholders' aspirations and how they compare to those of their competitors, the more appropriate these solutions can be to create short-term competitive advantage and position the company strategically and financially over the coming years.

Analysts looking at potential investment opportunities will invariably consider working capital and, increasingly, financial supply chain management. Doing these things well can mean the difference between the perception of having too much debt and a poor return on capital or being considered best in class, particularly during an economic downturn."

Summary of key points

VISIBILITY
- Higher cashflow visibility will allow you to make better, more rapid decisions.
- Achieve visibility by centralising cash management & rationalising international banking relationships.
- Use your bankers' expertise and experience and seek their advice.

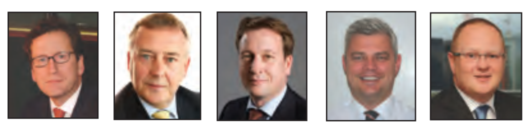
PREDICTABILITY
- Harness information across multiple locations.
- Streamline processes to reduce cost and improve control.
- Make cash work harder by using cash pooling structures.

REDUCE COSTS
- Focus on profit margins.
- Reduce, outsource or offshore back office or non-core functions.
- Re-energise the balance sheet by focusing on core activities.

MANAGE RISK
- Insure your company against defaults on receivables.

LEVERAGE ASSETS
- Take stock of your assets and explore use of an asset-backed working capital facility.

REDUCE COST OF DEBT
- Explore the use of interest rate swaps to hedge against the crunch.



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FORTIS

Cross Border Collaboration for the Enterprise and the Entrepreneur

THE BUSINESS CHALLENGE MidCorp Ltd (MCL) is a family-owned manufacturer of equipment and tools for the energy insulation sector, based in the north west of England. It has subsidiaries in France, Germany and Italy and an annual turnover of £175m. MCL is heavily reliant on energy to run its factories, and sources its other main inputs from the Far East and China. The bulk of its imports are in USD against an advance payment on purchase order and the total invoice is settled against receipt of the shipping documents. The inventory and sales cycle take about four weeks and MCL's clients receive on average 45-day payment terms.

MCL now has a unique opportunity to acquire a Polish company in the same sector for €75m (in Polish Zloty equivalent). MCL is concerned about its future profit margins given the volatility of energy prices and rising financing costs due to its negative working capital position.

MCL decides to raise the necessary financing through a combination of debt and equity, including a €50m bank loan and a private share offering sale to a private equity investor, equivalent to 25% of the family's share capital. It requests its main bankers to submit a proposal.

THE FORTIS SOLUTION Fortis is well-equipped for this type of scenario. Firstly, it is not only able to arrange a total funding package covering both debt and equity, but it could also refinance the existing company debt in an attractive and flexible way. Secondly, the bank has a presence in each of the countries in which MCL do business, including Poland.

Fortis has significant risk management advisory expertise, so hedging programmes can be put in place to help reduce a company's exposure to currency, interest rate and energy price risk. In order to reverse the negative working capital cycle, financial supply chain solutions for MCL could include import-to-sales solutions, and a choice between multi-country factoring or receivables financing with credit insurance, all of which are provided by Fortis. Furthermore, additional cashflow could be released by structuring a sale and lease-back solution for the German and Italian warehouse facilities, while group cash may be centralised through a cross-currency, cross-border notional cash pool.

Paul Cardoen, Managing Director, Commercial Banking, Fortis Bank UK, explains:

"Medium-sized companies have complex requirements but often lack the resource to dedicate to identifying all their financial risks and opportunities. An important service which many owner-managers rely upon is the quality of advice, such as in this situation, where setting up an intermediary holding company in a tax-neutral country could avoid double-taxation of dividends, and where protection of trade-marks and intellectual property becomes more important as a result of opening capital to new shareholders.

One benefit of working with Fortis is that a dedicated Global Relationship Manager who understands the business can pinpoint these issues and co-ordinate the necessary resource within the bank.

For an owner-manager, any financial solution needs to address the short-term business strategy, maintain liquidity and support his long-term ambitions for the business, which could include an exit strategy. It is important that the bank with which he works recognises these diverse requirements."

Aligning Business Strategy for Economic Growth

THE BUSINESS CHALLENGE "LargeCo plc (LargeCo) is a British clothing retailer, with outlets across the UK and Europe. The company sources its products from various countries, including Romania, Bangladesh and Mauritius. With market uncertainty in the UK, LargeCo wants to focus more of its activities in Germany, France and Spain, both through organic growth and acquisition. It also needs to protect its sales margin by keeping costs under control and maximising liquidity. One of the strategic opportunities it has identified is to open a new production facility in Turkey. However, the European subsidiaries lack the credit quality of the UK head office, so LargeCo is finding it difficult to source the necessary financing."

THE FORTIS SOLUTION Fortis is committed to recognising the financial quality of business groups as a whole – rather than individual subsidiaries. This makes it easier for international groups to seek financing. In LargeCo's situation, Fortis can provide a supplier financing programme to improve both LargeCo's and its suppliers' working capital. Asset-based finance can be provided for the new production facility, with the potential to release additional capital in the future through a sale and lease back arrangement.

Tony Wonfor, Managing Director, Corporate & Public Banking says: "During periods of market uncertainty, it is particularly important to maintain a very strong two-way dialogue between a company and its bank(s). By developing a deep understanding of the company's current business activities and future strategy, the right bank will be able to help a company through tough times and even capitalise on new opportunities that arise. For instance, Fortis' cross-currency, cross-border notional pooling is a viable proposition for businesses of all sizes operating internationally as it provides visibility and optimisation of cashflow without the need to set up intercompany guarantees.

There is also a range of financing opportunities available, which are specific to each company and business sector. Many companies are not leveraging their assets as successfully as they could. In many cases, companies put off financing decisions until too late. Spending time with a bank in the capacity of trusted adviser can help treasurers and CFOs uncover new financial opportunities for the business."