READY FOR ACTION

Companies are gearing up to return their excess cash to investors in 2015. So what will this mean for treasurers? Paul Golden investigates

A corporate action is any event that results in material changes to a stock. In its strictest sense, the term describes an event that affects the number of shares in issue (ie takeovers, bonus issues, rights issues and consolidations), but, in practice, it covers a much broader spectrum of activities undertaken by companies, including name changes, dividends and liquidations.

Data from a survey conducted by the ACT in September 2014 indicates that the volume of corporate actions is likely to rise over the coming months. Almost one in five (18%) respondents said they are running down cash aggressively, returning funds to shareholders and not replacing maturing debt.

This activity can be interpreted as share buybacks as well as not refinancing maturing debt, explains John Grout, ACT policy and technical director. "Companies have been holding cash both defensively and opportunistically. If potential target acquisitions are unable to raise finance, companies can use cash in acquisitions, both strategic and 'fill-in'. That also plays to companies wanting to spin off less favoured divisions or activities now that market prices are relatively high compared with the past – if not relative to companies' assessments of valuation."

Across the pond

The Association for Finance Professionals' (AFP's) corporate cash indicator for Q3 2014 reflects similar sentiment on the other side of the Atlantic. The report finds that growth in corporate cash holdings slowed dramatically during the third quarter of last year to the point that many companies had smaller cash holdings at the end of September 2014 than they did at the same point 12 months earlier. Respondents anticipated continuing to contract their cash holdings during the final quarter of last year.

"The debt market will remain very active. Issuers are keen to continue to replace existing debt instruments with new instruments that enable them to manage their cash flow more efficiently and reduce their exposures," explains Charlie Price, senior director of entity data products at financial information vendor Interactive Data. He adds that blue-chip US and European corporates, in particular, have been hoarding cash.

Price expects merger activity to benefit from the number of companies that want to grow their businesses through acquisition. "Whether it is through a buyback or increased dividend activity, firms are also looking to distribute the excess cash they have accumulated to their investors."

People shortage

As the economic recovery continues, and since many companies are awash with cash, it is likely they will do some restructuring. While the debt side of the business still looks very weak, there might be an increase in 'imaginative' corporate actions to invest for the future and it would not be surprising if there were an uptick in M&A activity. That is the view of Gary Wright, CEO of BISS Research, who is concerned about the availability of expertise to support a significant increase in mergers, acquisitions and spin-offs in 2015.

"Top-quality corporate action settlement people are hard to find and temporary staff will never fill the gap," he says. "Financial services firms should have invested in developing these professionals during the downturn, but did not since costs were the focus. Equally, many corporate action systems projects were stopped to allow concentration on perceived high-profile regulatory changes."

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Meanwhile, Brian Okupski, MD and head of the corporate actions validation service at financial information services provider Markit, says that most organisations are not set up to maintain in-house corporate actions specialists.

But the ACT’s Grout is confident that most, if not all, of the additional expertise likely to be required over the remainder of this year is available within treasury departments. “Investment banks are queuing up to offer advice, but as banks have cut back on staff there may be some lack of experience there,” he says. “Larger companies have in-house skills for many aspects. Someone who has completed our educational qualifications has the background, although it helps if they have seen it done or done it before so they know better how to evaluate the narrative that banks tell firms when they propose corporate actions.”

Role of treasury

Having worked on dozens of M&As prior to joining the AFP, director of treasury services Tom Hunt observes that one of the roles of treasury is to ensure that the liquidity exists to enable a corporate action to take place. It can play other important roles as well, including advising on strategy and supporting due diligence. Hunt notes that “treasury is often brought into the process at a relatively late stage due to the requirement for confidentiality”. This is a situation that many treasurers lament, however, since they are able to make a valuable contribution to M&As from an early stage.

One of the required skill sets for the treasury department is thoughtful analysis and preparation. The team may not have previously gone through an acquisition process, in which case they will lean heavily on their banking counterparts to provide strategic advice, he continues.

“In many of the transactions I was involved with, we didn’t hire external parties. We had the necessary skills in-house, but that only comes about through investment in education and working closely with providers to determine the optimal financing option. Depending on the size of the transaction, there can be a lead agent engaged to help structure the deal from a funding standpoint, but many of the other skills required are often already in place within the treasury team.”

Price says he would be surprised if there was a shortage of the type of expertise required to support this growth in corporate actions. “Traditionally, corporations will be working with investment bankers and lawyers, and there are plenty of those out there, so I don’t see this being a major stumbling block to events being managed correctly. Firms are looking for quality data disseminated in a timely manner and automation to manage the processes, and there has been a real focus over recent years on automating the corporate action process, from the initial notification of the event to completion. There is significant exposure for firms, especially on voluntary events where there is an election or decision to be made.”

Daniel Thieke, MD of US settlement services provider the Depository Trust & Clearing Corporation, refers to an

DON’T EXPECT A WINDFALL

Corporate actions don’t always produce a profit for investors. For example, when Vodafone agreed to sell its US group (whose principal asset was its 45% stake in Verizon Wireless) to Verizon Communications, it intended to consolidate Vodafone shares and return part of the capital of the sale to existing shareholders.

Shareholders had their existing Vodafone shareholding reduced via the consolidation and received a sum of cash and a quantity of new Verizon shares that compensated for the reduced market value of the Vodafone shares.

In an advisory note, retail stockbroker The Share Centre observed that while pre-event hype had raised expectations of an investor windfall, Vodafone was simply returning capital to shareholders.

increase in what he describes as "more complex events" that is likely to extend beyond 2015 as a factor that will impact on the availability of in-house expertise. "The extent to which global markets can harmonise the way events are announced and processed will address some of these resource issues by making it easier for firms to hire people and bring them up to speed."

Okupski suggests that corporate actions are conducted with greater levels of transparency in more developed markets. "We tend to spend less time deciphering and 'second-sourcing' complex divestitures or acquisitions in the US than we would in Russia or sub-Saharan Africa, for example. In situations such as this, we usually end up contacting the corporate directly and speaking with someone from treasury to get a better understanding of the event and the necessary detail."

Minimising risk

When asked whether corporates have become more adept at minimising the risk factors in a corporate action (such as the downstream impact of registering an event incorrectly), Okupski observes that treasurers face time constraints when distributing information.

"They won't want anything happening in the company before they have alerted their investors. The trade-off is typically that this information is not complete when it is broadcast to the market, so the treasurer may have to go back to the market with additional details. We saw an example of this recently when a dividend – which should be the most straightforward type of event – was declared and the corporate had to subsequently adjust the dividend to account for the treasury shares."

On the question of whether sufficient progress has been made towards harmonising and standardising corporate action processes, Grout suggests that while standardisation in some of the process and boilerplate documentation might be helpful, and that harmonisation is seen as a positive development by investors, corporates generally don't welcome standardisation as they want what they do to fit their situation.

"Progress in this area has been very slow and the drop-off of corporate action activity over recent years – coupled with other priorities – has left much still to do," says Wright. "I doubt that trying to introduce change by committee is fast enough. After all, they have spent decades discussing the issue and we still have no harmonisation."

Grout's view on whether corporates have become more adept at minimising the risk factors in a corporate action is that chief executives are unduly concerned by risks, since they see failure to do something as their own failure. "For instance, who predicted the timing or scale of the global financial crisis? If you use an investment bank for advice – as opposed to mere execution, which regulation often requires an authorised person to do – timing is part of what they bring."

There is still a high level of risk in corporate action processing throughout the industry, concludes Wright. "Corporates continue to find new, more complex events and international cross-border corporate actions are still loaded with risks."

IMPACT ON CREDIT

The key element of a corporate action from a treasury perspective is its impact on the credit profile of the company, explains Rando Bruns, head of treasury at chemical and pharmaceutical company Merck.

"Support of treasury is often vital to the success of a corporate action, since the credit profile of the company may be impacted. The corporate action and its implications need to be communicated and explained to banks and rating agencies by treasury."

As the volatility of financial markets has been far higher since the global financial crisis, there is even more emphasis placed on minimising financial risk "in the business generally, but also, or especially, when it comes to corporate actions", he concludes.

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