# Ask the experts:

# Embracing the new normal

A TREASURER AND TWO BANKERS PREVIEW THE THEMES AND THE MARKET BACKGROUND THAT LOOK SET TO COLOUR THE THINKING AT THE ACT ANNUAL CONFERENCE 2009.

**Matthew Hurn, group treasurer, Mubadala Development Company, is chairman of the ACT Annual Conference 2009** This is a fantastic time to be a treasurer. Both the credit crisis and the economic downturn have ensured that the profile of the treasurer within their organisations has developed and continues to grow. Many treasurers have really earned their spurs over the last few months by demonstrating the value-add that they can offer. At the moment it is clear that treasurers should have a seat at the top table and we have to make sure that place becomes firmly established.

But let's not get carried away; we still have to keep our eyes on the basics of cash management and ensure we get those right.

I have said before at conferences that in good times and in bad times we have to ensure we do the simple things right before we start to look at using more complicated or sophisticated techniques or instruments. For instance, in the current climate it is essential that treasurers look to internal liquidity before they start looking at external funding sources. To do that, treasurers have to engage with the business to understand its cash drivers. This process of embedding treasurers with business units has never been easy and even in today's climate it remains tricky. Both sides have to be willing to make that happen.

Treasurers have to ensure the visibility of internal cash because going to external sources for funding isn't cheap at the moment. When looking externally, treasurers need to understand the pockets of liquidity that may be available to them. And perhaps that should include looking further afield than bank lending or bond markets to sources such as Islamic finance and commercial paper.

One of the key messages that is bound to emerge from the ACT Annual Conference is that we are all now living in a different world. However, treasurers should embrace the new normality and ensure, where possible, that business continues.

Above all, treasurers need to protect and enhance shareholder value. But don't let that be an empty phrase: treasurers need to understand the value drivers and appreciate what shareholders are really after.

Part of that value enhancement in the current climate can happen by treasurers widening their areas of responsibility. Treasurers have talked for a long time about their challenge to take on the risk portfolio across the enterprise and it now makes even more sense for us to take the lead on enterprise risk management. For instance, insurance is a financial risk and therefore one which should fall under the treasurer's remit. But I think those responsibilities could go even further and start to include greater (although not complete) responsibility for investor relations. Why investor relations? Because it falls into that theme of providing a coherent and consistent theme for all stakeholders.

It is a fully and exciting agenda and one which the treasury profession is well equipped to embrace.

**Jonathan Chesebrough, senior director for corporate finance and risk solutions, RBS Global Banking & Markets** The last two years have seen a transformation of the financial markets that corporates rely on, both to raise capital and to hedge their risks. The "new normal" of increased market volatility and restricted bank capital, coupled with the severe economic downturn, has prompted many treasurers to re-assess their risk management strategies to ensure that they are appropriate in the new world. The following are a sample of areas we have advised and seen corporates act on.

**Review of transactional hedging policies** Many treasurers have revisited their transactional hedging policies, reviewing tenor, how they are impacted by peers, and if there are more suitable alternative methods to implement hedging approaches. For tenor, the extreme market volatility has highlighted that policies focused primarily on protecting budget could be improved by lengthening the hedge to cover the period needed to make operational and/or pricing changes to compensate for market movements. If peers have different sensitivity to market movements and/or different pricing power that could lead to a loss of market share, corporates are compensating with more use of options. Also, more and more corporates are examining the use of a layered approach by entering into multiple hedges related to a particular period over time instead of hedging all at once, as this approach diminishes volatility over time, rather than just deferring market moves to a future period.

**Managing risks to financial flexibility** Increasing focus has been placed on managing risks to financial flexibility where possible, most notably by adjusting the currency mix of debt. As a result, corporates are now calibrating the cashflows of the organisation to the debt being used to finance operations. Broadly, this typically means aligning debt in the same

currency proportions as underlying cashflows, as this minimises risk over the long-term to credit metrics such as net debt/EBITDA. This has led to a departure from historically more common strategies such as hedging net assets or pursuing cheaper cost of funding.

**Less credit-intensive hedging approaches** Where possible, treasurers are making use of less credit-intensive hedging approaches to save available credit lines in case they are needed later. A simple way to do this is through the purchase of options, although this has to be weighed against increased cost arising from higher implied volatilities. It is also becoming common to free up credit lines by unwinding credit-intensive positions where cash is available and/or it does not introduce undue risk.

**Using strategies to take advantage of low interest rate and high implied volatility environment** Treasurers are increasingly adjusting risk management and funding strategies to take advantage of the current low interest rate and high implied volatility environment. This could involve cash saving adjustments to floating interest rates such as the use of basis swaps (for example, swapping from three-month to six-month roll periods) or Libor-in-arrears. Many corporates are also selling volatility to receive potentially lower funding costs through cancellable hedges, which can be structured in an accounting-friendly way when combined with the underlying funding.

**Jamie Stuart, managing director, head of UK debt origination, Deutsche Bank**

The notable feature of issuance seen since the beginning of the fourth quarter of 2008 is the pick-up in the past few months, including January's record rate in Europe, which has overcome concerns as to whether debt capital markets will continue to function successfully in the wake of the Lehman and Washington Mutual defaults. With this in mind, we focus on the breakdown of these recent new issues from both a sector and rating perspective.

An analysis of the euro market sector breakdown shows that 40% of total issuance has come from either telecom or utility companies. And if we further include consumer non-cyclicals and energy companies to make up the group of more defensive issuers, then this accounts for nearly 70% of issuance since the start of the fourth quarter. However, at the end of November 2008 these more defensive sectors accounted for around 80% of total issuance, so companies from less defensive sectors are also beginning to access the primary market to raise capital, with consumer cyclical names having risen from less than 5% of total issuance at the end of November 2008 to stand at around 15% currently.

When we look at the rating breakdown in the euro market it is also of a defensive nature. Nearly 80% of all issuance has been rated single-A or higher. That said, we have seen more evidence recently that lower-rated issuers have been able to access the market as the proportion of issuance from companies rated BBB or below has risen from below 10% at the start of 2009 to above 20%. This includes the first European high-yield deal, Fresenius, since mid-2007.

Being notably smaller, the sterling market has seen far fewer issues but on the whole is certainly weighted towards the more defensive sectors. What is interesting in the sterling market is that issuance has been focused on longer-dated bonds, with just under 70% of supply since the beginning of October 2008 having a life of more than 10 years. Around a fifth of the total has been rated BBB, and more than half has been rated single-A.

While the euro and sterling markets have shown similar characteristics, particularly in their weighting towards the telecom and utility sectors, the dollar market is rather different. Telecoms and utilities make up a combined 28% of total issuance, much lower than in either the euro or sterling markets. That said, issuance has still been weighted towards defensive sectors, with consumer non-cyclicals and energy names making up about 30% and 20% of new deals respectively since the beginning of the fourth quarter of 2008. But while issuance in the defensive sectors may have been slightly more prevalent in the dollar market than the euro market, there have been far more lower rated deals in the US. Dollar bonds rated BBB or below have made up more than 35% of the total supply over the last six months or so, more than 5% of which has been high yield (over $14bn).

In conclusion, the pick-up in the new issue pipeline over the last few months has been dominated by the generally more defensive sectors and, in the case of European markets, it has also been biased towards higher rated companies. That said, we are seeing evidence that companies in the less defensive sectors can get deals done but on average those deals will be done at wider spread levels.


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