cash management
CASE STUDY

Concrete and clay

AS A LEADING EUROPEAN PRODUCER OF BUILDING MATERIALS, ETEX GROUP'S PRODUCTS ARE HIGH VOLUME BUT LOW VALUE – WHICH RULES OUT OUTSOURCING TO LOW-WAGE COUNTRIES. GROUP TREASURER JOHN HOLMES OUTLINES ITS CASH MANAGEMENT ISSUES TO **GRAHAM BUCK**.

Executive summary

Group treasurer John Holmes explains the cash management policies of the Etex Group following the corporate activity of recent years, the central importance of the foreign exchange (FX) policy and the challenges of centralising cash and debt in a bid to use surplus cash to repay debt.

Notable events of 1893 included the World's Fair in Chicago, while Thomas Edison constructed the first motion picture studio, Rudolf Diesel secured a patent for the diesel engine and in Austria the firm of Eternit-Werke was founded by industrialist Ludwig Hatschek.

In 1905, Alphonse Emsens acquired the Belgian licence to exploit the Hatschek technology, using the name Eternit. A full century on, the Belgian Eternit has developed into Etex Group consisting of 90 affiliated companies, with a global presence in 42 countries and a workforce of more than 14,000 people.

Much of this growth has come over the past two decades. Eternit Belgium bought its German counterpart, and then bought out the minority stake in Eternit France to full ownership. Soon after the latter deal it adopted the name Etex Group, to reflect a wider range of products that now included fire protection systems, roofing materials and plastics.

Group treasurer John Holmes came on board in 1999, having served as group treasurer for UK-based building materials group Marley, which Etex acquired that year.

Post-acquisition, Holmes' first task was to arrange finance for repayment of Marley's debt and the acquisition bridging loan. Etex Group acquired 80% of the assets of UK group Glynwed in 2001, making it a worldwide leader in plastic pipe systems (the deal also saw Glynwed retain its Aga and Rayburn ovens business and relaunch as Aga Foodservice).

Not only did this purchase create high debt levels and the need to refinance, it also took place only months before already shaky economic confidence suffered a further blow from the September 11 terrorist attacks. The next couple of years were "tricky" as a result, but business disposals and its strong cashflow saw the group make the planned debt repayments.

TWO SEPARATE ENTITIES By 2003, conditions had stabilised and in June that year Etex Group's shareholders approved its demerger into two separate entities of roughly equal size; building materials and plastics for the plumbing sector. The latter was spun off under the title of Aliaxis, while Etex retained the "heavy side" – roofing, boards and fire protection businesses.

"Refinancing proved to be a fascinating exercise, as individual banks took on very different views of the two businesses," says Holmes. Some proved more supportive of Etex Group; others preferred Aliaxis – often quoting the same reason for taking an opposite view.

The group undertook a subsequent refinancing in 2005, to benefit from the then more favourable market conditions. Despite private equity firms snapping up acquisition opportunities at prices higher than the group was prepared to match, it was nonetheless able to buy into the German market for clay roof tiles through three acquisitions, of which the biggest was market-leader Creaton.

"Ideally, we would also like to further expand our presence in France," he says. "But the price being paid for deals continues to be too high. Instead we're spending heavily on organic growth across Europe, including the eastern countries."

THE GOOD YEARS Thanks to low interest rates, recent years were good for Europe's property markets and for the

construction and building materials industries. Along with consumer goods, demand for building materials is a good indicator of the state of the general economy, being highly sensitive to changes in interest rates and mortgage loan issues.

"In fact our profits have a far greater exposure to the economic effect of rate fluctuations than they do to the effect of rate fluctuations on our debt," says Holmes.

"We don't hedge this economic risk as it is impractical to do so and the resultant smoothing would work against us just as often as proving to be in our favour."

Foreign exchange (FX) exposures in Europe are partially centralised in the Belgian treasury operation, the exposure from importing fibres from the Far East in US dollars and Yen, although both are relatively small exposures in relation to the group's overall purchases.

Its main non-centralised FX exposures in Europe are in the UK – as the UK companies buy and sell in euros, treasury is working to standardise procedures for managing and reporting FX exposures and other treasury risks.

"Groups such as ours are dubbed multi-domestics – as opposed to multi-national – as we manufacture, to local specifications, from locally sourced materials selling locally, in the same currency," says Holmes. As a result Etex Group does not have major currency transaction risk.

So what maxims does the group follow to achieve effective cash management? Due to its culture of decentralisation, management of working capital is not a treasury responsibility. Holmes says that one operational point is to lessen peaks and troughs and the resulting need for more credit lines, as well as tackling the giving of excessive credit.

"In various markets, generous credit is both given and taken – for example Southern Europe – and some of the weaker secondary brands give generous credit that could be cut back.

"In Germany the tradition is to give excessive discounts for early payment and to take similar discounts offered by suppliers. This distorts perceived working capital levels and the cost of them."

OBSTACLES TO CENTRALISED CASH The decentralised nature of Etex's operations has proved an obstacle to the aims of centralising cash and debt and to using surplus cash to repay debt.

Etex took the decision in 2003 that it preferred notional pooling over zero balancing. Before then, Holmes explains, "we were too occupied with M&A activity and divestments to have enough time to devote to cash management".

The use of notional pooling has steadily expanded over the past five years, initially in the UK where the group used LloydsTSB. The notional pool in Belgium with KBC, in Luxembourg – where it has some major financial activities – with BNP and in the Netherlands with Fortis, are managed from Brussels. The pools reflect the distribution of ancillary business and there is no intention to change this. In France, the group has instead put in zero balancing pools through its main French company, using Natixis.

The French and UK companies manage their own pools

ALONG WITH CONSUMER GOODS, DEMAND FOR BUILDING MATERIALS IS A GOOD INDICATOR OF THE STATE OF THE GENERAL ECONOMY, BEING HIGHLY SENSITIVE TO CHANGES IN INTEREST RATES AND MORTGAGE LOAN ISSUES

with manual centralisation to/from Brussels as necessary. Similarly, other countries are centralised for major funding. Etex Group uses banks' own reporting systems as well as ISABEL for bank movements (unsorted by value-date) and daily bank balance reporting. ISABEL version 6 has been considerably delayed, but the group hopes to complete the upgrade shortly.

Carrying out notional pooling involves reporting and assessing the daily balance, while setting up pools requires appropriate legal documentation and raises a number of issues. Prominent among these is capital weighting charges and the means by which they can be avoided, or at least minimised. Etex Group has managed full notional cross border pooling without incurring capital waiting charges.

"Notional pooling involving a full pooling depends on the laws of the country," says Holmes. "One solution is to zero balance to a 'friendly' jurisdiction, such as the UK or Holland, and pool there.

"Another option is full notional cross-border pooling, although this depends on the bank as to whether it can be achieved, as well as in-country issues." It has been made difficult in Germany due to recent case law, while French law prevents notional pooling as interest can't be paid on a credit balance.

"Full cross-border pooling means a balance in Germany can be pooled with one in Belgium without involving any movement of funds," Holmes adds. "We intend to investigate extending it, initially to units in Poland and Hungary before adding smaller units.

"Although we have some major factories, the group isn't entirely composed of easy-to-manage large units and there is also a substantial scattering of smaller ones. So the latest cash management phase will attempt to bring some of these in, using the most efficient means possible."

Cash management would be improved by netting inter company payments and the creation of significant payment factories. The issue is treated as a divisional one – the group's three main divisions being European Building Materials, International Building Materials and Fire Protection and Insulation.

Cash pooling is run across the trio, with treasury based in the co-ordination centre, but this regime is scheduled to expire at the end of 2009 and the group is reviewing possible changes.