Laporte opens the door to liquidity management

Mike Nicholson of Laporte details how the group's restructuring has affected its long- and short-term cash management.

Laporte has undertaken a substantial restructuring exercise over the past four years. Non-performing assets have been sold and headcount at head office and subsidiary levels has been reduced. As part of this restructuring, treasury headcount was reduced from seven to three (although it has now crept up to four), with the result that we had to dramatically re-think how we should go about things.

A clean sheet

We decided to start with a clean sheet of paper and listed the things we wanted to do and then asked our banks to come up with ways of meeting these requirements. As a result, we outsourced a lot of the routine, back-office functions so that we could concentrate on strategic issues. The fact that we still need four staff reflects our highly centralised operation controlling all borrowings, all investments, all foreign exchange transactions and indeed, all cash management operations from the centre in London.

We operate cash management systems in seven countries, a cross-currency pooling system, a cross-border netting system involving both inter-company and third-party supplier payments and a centralised foreign exchange transaction hedging programme. The last three items have all been implemented following our 'clean sheet' review.

Outsourcing

We had wanted to put in place a netting system but headcount reductions made it impossible in-house. We therefore outsourced the operation to a niche cash management bank. Coincidentally with the netting system we introduced a cross-currency pooling system with the same bank to use this as the platform for a centralised foreign exchange transaction hedging programme.

> In 1999, the money market fund is a key feature in Laporte's approach to liquidity management. In 1998 only a fraction of our investments were placed in money market funds, now that figure is 100%

This programme requires that all our subsidiaries provide a monthly rolling 12-month forecast of foreign currency payables and receivables. This information is sent to Bank Mendes Gans which assimilates the information and provides treasury with a report detailing the group's net exposure. Treasury will then hedge the net exposure in accordance with its policy of hedging between 75-100% of exposures forecast to materialise over the next three months, falling,

Mike Nicholson

Laporte plc

Profile: A leading manufacturer of speciality chemicals and performance materials, it is currently ranked 170th in the UK FTSE 250. It is the fifth largest company in the UK chemical sector behind ICI, BOC, Burmah Castrol and Johnson Matthey and the second largest speciality chemical manufacturer.

Headquarters: UK

Cashflow:
Annual turnover to 30 June 1999:

UK	£286m
Euro-zone	£195m
US	£349m
Market capitalisation:	£1.1bn

Reporting currency: Sterling

in bonds to a level between 0–25% for exposures expected to materialise in 10–12 months' time. Treasury also acts as an in-house bank and enters into forward foreign exchange contracts with each subsidiary to hedge its identified exposures. The mechanics of this operation are effectively outsourced to the bank with control maintained by Laporte.

Objectives

The main objectives of Laporte's treasury are:

- liquidity management;
- to minimise borrowing costs (very important these days with debt of around £500m);
- to minimise currency exposures;
- to optimise the use of surplus funds (although these days it's more a question of making sure that any surplus funds anywhere in the world are

used to pay down borrowings); and
- to maximise returns while minimising risk.

Main responsibilities
Our main responsibilities include:

- cash management;
- debt management;
- interest rate and foreign exchange hedging;
- worldwide bank relationships; and
- negotiation of worldwide borrowing facilities.

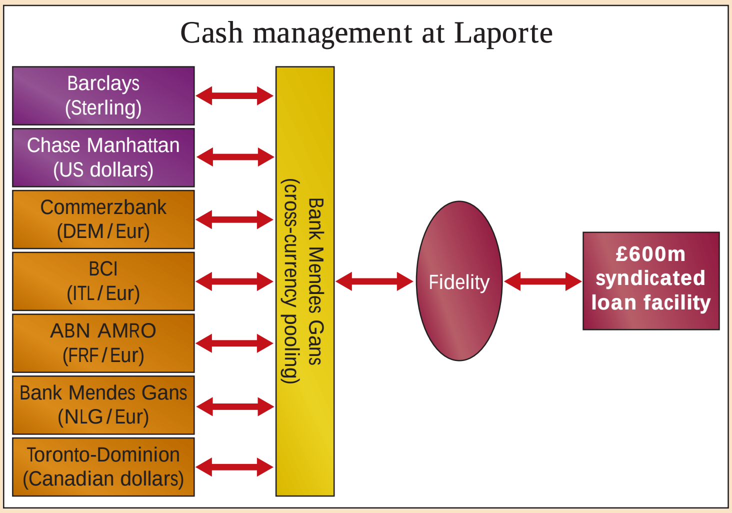
To carry out this workload we have had to devise further ways of using our resources more effectively. The principal areas in which we have achieved this are cash management and the investment of surplus funds.

We have pooling or concentration systems in place in all of the major territories in which we operate. Hence we have systems in place with Barclays in the UK, Chase in the US, Commerzbank in Germany, ABN AMRO in France, Banca Commerciale Italiana in Italy and Toronto-Dominion in Canada. We also use Bank Mendes Gans in Amsterdam for our cross-currency pooling activities as well as our Dutch domestic requirements. The cross-currency pooling system allows us to notionally offset the credit balances that may arise on, for example, our euro and US dollar pools. In total, we have 12 currency pools at the bank.

Bank relationship policy
Our policy is to use one bank per country unless there are relationship reasons for doing otherwise. For example, if a bank has shown its commitment to us by lending us money we will not take away any retail banking business it may have. On the other hand, if a bank has not been prepared to use its balance sheet to support Laporte, our policy is to replace it with one that has. Our consolidation process is ongoing and we have just finished a review of our US lockbox arrangement and have consolidated all our lockboxes with Bank One.

As shown in *Figure 1*, we use Bank Mendes Gans as the pivot for our worldwide cash management activities. If there is surplus sterling in the UK and a euro overdraft in Germany, we will move sterling from Barclays to Bank Mendes Gans and transfer the equivalent amount of euro from Bank Mendes Gans to Commerzbank. In some cases, this is done electronically using the domestic bank's software, for example Barclays Business Master International or the Chase Insight system. In other cases, for example, Commerzbank, Banca Commerciale Italiana, and HSBC and Bank of Scotland in the UK, we use the multibank capabilities of the BMG Mega Workstation to move funds from our accounts in Germany, Italy and the UK to those in Amsterdam.

FIGURE 1



We would like these movements to be automatic. For example, if there was an overdraft at Commerzbank, funds would automatically be transferred from Bank Mendes Gans to clear the balance.

Foreign currency accounts
All the foreign currency accounts of our subsidiaries are located at Bank Mendes Gans. At present these total some 230 accounts operated on behalf of 70 subsidiaries. In addition to foreign currency accounts, each subsidiary will also have an account in its indigenous currency with Bank Mendes Gans.

As stated earlier, if we were long of sterling and short of euro, we would use Bank Mendes Gans as the conduit to move funds from the UK to Germany. If there was a net surplus within the eight cash management systems that we operate and we knew that this cash would not be needed for some time, we would, ideally, prefer to use this cash to repay drawings under our £600m syndicated loan facility.

However, such facilities are not overly flexible, with drawdowns being restricted in number, and maturities having to be for periods of one month or longer. This being the case, if we have surplus cash in the indigenous cash management systems we will draw the surpluses into Bank Mendes Gans, convert them into sterling and then invest those funds in a money market fund (Fidelity) until such time as we have a syndicated loan drawdown maturing.

Investment management policy
Laporte's investment management policy is that the company only invests funds with institutions that have long-term credit ratings of A1 (Moody's) A+ (Standard & Poor's) or the equivalent Fitch-IBCA rating. We have the ability to use bank or building society deposits, bank or building society certificates of deposit, commercial paper, repos, treasury bills, FRNs and, of course, money market funds.

Why choose money market funds?
Why did we include money market funds in the list of approved investment types? The reasons can be divided into five categories as follows:

- **diversification** – we were looking, initially, at money market funds as an alternative to banks and building societies for our short-term deposits;
- **security** – as previously stated, we only invest with institutions that are rated at least A1 and even then we always have additional criteria that need to be met. We are therefore more than happy to invest in money market funds that are rated AAA and that have in place investment criteria at least as stringent as our own;