A CHANGE OF OWNERSHIP CAN LEAVE A BUSINESS DIVISION REQUIRING A WHOLE NEW TREASURY DEPARTMENT TO BE SET UP QUICKLY AND EFFICIENTLY FROM EXCHANGE OF CONTRACTS – USUALLY UNDER THE COMMAND OF AN INTERIM TREASURER. NUMEROUS ISSUES WILL ARISE SUCH AS THE FORMATION OF RELATIONSHIPS WITH NEW FUNDING BANKS AND ARRANGEMENT OF NEW FACILITIES... WHERE SHOULD THE TREASURER START? **GRAHAM BOND** REPORTS.

Building a new treasury

The most frequent driver for setting up a new treasury department is a change of business ownership as a result of the sale or flotation of an individual business. In this event, a number of experienced treasury people will be required to undertake interim type assignments in what can be highly pressurised, fast-changing situations.

Examples of when a new treasury set-up will be required include:

- When a government sells a public sector business and either seeks to float the new business on the country's stock exchange or looks to find a trade sale. The energy, utility and banking sectors have seen many such deals recently, particularly in central and Eastern Europe.
- When a multinational decides a division is non-core and holds an auction sale. Frequently, venture capital firms become involved in the bidding process, and if one wins then a whole new treasury function will definitely need to be set up.
- In hostile takeover situations, where the existing owner decides to de-merge and float the separate parts of the original group.
- When venture capital firms acquire and combine businesses, and the new combined business becomes of a sufficient size to warrant a new group treasury activity.

In all these situations, there are often many twists and turns that must be navigated before the buyer of the organisation becomes fully known. This means that any potential new owner will have to wait until the deal is fully agreed before committing to hiring any new financial and treasury skills for the business.

Executive summary

- Change of ownership is often the main driver for a new treasury set-up. The sale of a public sector business, sale or flotation of a non-core business division and break-up and flotation of individual businesses are situations which call for the establishment of a new treasury function.
- Experienced treasury professionals will be required in the interim to handle the changeover in what can be a high-pressured, fast-changing period.
- Involvement in the set up of a new treasury may appeal to some treasurers as it can provide some very good experience over a short period of time. The interim treasurer can expect to be responsible for the smooth running of the treasury during the deal period and for some time after.
- Key issues a new treasury set-up will face include the ongoing provision of cash management services and overdrafts, provision of currency and interest rate hedging lines, and building new relationships with funding banks.
- Short-term solutions include ensuring a step-by-step process for banking arrangements and the immediate establishment of a framework for good treasury management.

Although some deals allow 60 days from exchange of contracts to close, it is much better if a treasury resource – for example, an experienced interim treasurer – is lined up to start as soon as contracts are exchanged. This allows more time to:

- Understand the new business being created, including the financial risks of the company, so suitable treasury policies and procedures can be created and implemented from day one.
- Sort out the final rounds of negotiations for new funding facilities.
- Consider the interest and currency risks and determine whether any pre-hedging should be undertaken between exchange of contracts and close of the deal.
- Work on the banking problems that may arise with the change of ownership. This is particularly the case if the new entity has a much higher level of gearing and the existing funding banks are being backed out for a new group of banks.

If the time allowed to close the deal is only 20 or 30 days, then this can result in a dangerously high workload in a short period of time and the risk that some key issues will be overlooked or incorrectly analysed.

SKILLS REQUIRED FROM THE START. Being involved in the set-up of a new treasury may appeal to some treasurers as it can provide some very good experience in a short period of time. However, invariably, they may reach a point at which they would like to continue working for the company and, at some point, the allure of future equity participation may just help swing the decision that way.

When any large financial deal closes, and for a period after, a range of skilled technicians and advisers acting on behalf of both the acquirer and the seller must be dealt with. It will be down to the interim treasurer to fit in with these teams and make sure the changeover period runs smoothly.

Often a deal will involve transaction support teams from one of the main accounting firms to cover the range of financial disciplines involved. With complicated changes in the regulatory environment currently affecting all treasury operations, specialists with in-depth knowledge of new regulations such as IAS 39 may also be required to offer their input on any pre-hedging issues. Banking executives from the new funding banks will also want to get involved to see the deal completed; they will also all be hoping for a lead relationship afterwards.

TREASURY-RELATED PROBLEMS AND ISSUES. Numerous problems and issues may arise on the closing of a deal. For example, the repayment of existing bank facilities, could upset the currency balance sheet matching of overseas group companies and currency assets.

If performance bonds to customers and counter-indemnities provided by the existing banks have some years to run, the existing banks may either no longer want to provide the counter-indemnities or they may request increased margins. Even worse, they may demand 100% cash collateral to be provided by the company to reflect its increased gearing and credit risk.

'BEING INVOLVED IN THE SET UP OF A NEW TREASURY CAN PROVIDE SOME VERY GOOD EXPERIENCE IN A SHORT PERIOD OF TIME'

Short-term solutions to aid a new treasury set-up

A number of solutions can be implemented in a new treasury over a short timeframe to deal with the issues that arise:

FUNDING/CURRENCY BALANCE SHEET MANAGEMENT MISMATCHES. It is important to check the senior credit facilities in place thoroughly. If ancillary facilities have been included and can be booked in certain group companies, denominated in certain currencies, you should apply for some working capital currency debt to be drawn down by those companies. Do work out the tax position before doing so.

BANKING ARRANGEMENTS. This is a step-by-step process and involves collecting bank account information from all companies and resolving issues with any bank that is complaining. You should consider rationalising the number of banks per country – the target may be to move down to just one cash management bank per country – and introducing electronic bank reporting of cash balances round the group.

Where possible, you may want to introduce automatic sweeping of cash into some newly-created centralised bank accounts. As part of this, it is worth considering notional or actual cash pooling arrangements for group companies in Europe and the US for major currencies like the euro and US dollar.

It is also worth investigating which banks in the senior credit facility could provide cross-border cash pooling. Banks that are not in the new funding facilities will be unlikely to take on the credit exposure of such arrangements.

HEDGING FACILITIES. Check the senior credit facility to see which banks will offer hedging facilities and begin negotiations with them as soon as possible. Set yourself the objective of having the necessary International Swaps and Derivative Association (ISDA) documentation in place with each bank within the first two months, and preferably before dealing begins. But you must be careful not to enter hedge agreements too quickly after the change of ownership, as cash forecast information in the first few months can be incomplete and, consequently, may give you an unreliable picture of the company's exposures.

LOAN FACILITY AGREEMENTS. If necessary, you should seek help in the interpretation of such agreements – first from your company's lawyers – before approaching the funding bank's lawyers. Start briefing the company's financial controller on the new financial compliance requirements and start collecting information so that dry runs of financial ratio covenant calculations can be undertaken. Do not underestimate the workload here!

NEW TREASURY FRAMEWORK. You also set up a framework for good treasury management. Write a board paper on the main treasury policies, the people involved and their responsibilities and authorities. Then ask the new directors to consider and adopt the treasury policies paper at a board meeting at an early stage. You should also consider issuing interim treasury guidelines, to be practised in first six months, which should preferably be signed off by the finance director. It is also important to offer help to group companies on any new treasury management practices that the directors wish to see adopted. Write and issue a treasury manual, which is signed off by the finance director.

CASH FORECASTS. Good cash forecasts are key for many areas of treasury management. For a new company, such forecasts will often require a lot of work to start up, and to achieve the right input from divisions and operating units.

The forecasts need to be prepared on a rolling basis and by each main currency. They will also need to be consolidated so that one group funding position is calculated at least

In the case of cash management, the existing providers here may no longer wish to continue with overdrafts or suchlike, and may not permit any daylight credit exposure. At the same time, while information on cash and currency flows may have been sufficient when the company was part of a much larger group, in the new standalone company, amounts of smaller value may become relatively more significant.

Currency and interest rate hedges will be closed out at deal completion and hedging lines withdrawn, but business units in the new company may still need transaction hedging lines at the outset of the new company, making this another key issue.

Relationships will also have to be built with a new set of funding banks. If the company makes a request, it will have to go through a new set of procedures as defined in the new loan facility agreement. This takes time and the outcome may be uncertain.

There will also be immediate issues regarding large complex loan facility agreements and their practical interpretation. This often ends up in the hands of the banks' lawyers who lead on the drafting.

ACTIONS, TIMING AND GAMEPLAN. When setting up a new treasury function, many actions need to be taken in a short space of time. So what should your gameplan be?

It is important to prioritise your workload and stay focused, and there is no harm in achieving some minor goals early on. Significant objectives will take longer to achieve and should be treated as internal projects with a project plan set up, key tasks and milestones identified and a timetable prepared. It is also important to set up and document processes, and explain these to others in the company so that once they are trained they can take over. Within the first two months of a deal closing, you must also ensure that a consensus view has been formed on the ongoing treasury resources required and start the recruiting process.

HAVE A SIX-MONTH PLAN. Invariably, it will take about six months from the change of ownership of a company for treasury matters to settle down. Any immediate treasury issues and problems should be worked out and resolved within this period.

This includes the recruitment of the new full-time treasurer. Interim treasury policies and procedures should last for at least six months and then be reviewed by the full-time treasurer as one of his/her first tasks. New systems such as electronic banking, a Reuters or Bloomberg screen and interfaces with companys' financial information systems also need to evolve quickly within the first six months.

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