cash management
CASE STUDY

A balance sheet to die for

MOCKED FOR ITS PRE-CRUNCH RESISTANCE TO GREATER GEARING, THE MORRISONS SUPERMARKET CHAIN IS NOW REAPING THE BENEFITS, AS **GRAHAM BUCK** REPORTS.

Executive summary

Morrisons has had a great credit crunch. Its credit facility still runs for another three years and the business is highly cash-generative.

Supermarket chain William Morrison has ambitions to maintain its impressive growth and expansion programme of recent years (see the November issue of The Treasurer, page 34). At the same time, it has exercised caution in not following its rivals into areas such as expansion outside the UK, and makes a virtue of its "conservative balance sheet principles". Although he announced last year that he was stepping down as chairman after a 55-year career, Sir Ken Morrison is still the group's primary shareholder and continues to have an influence.

"The balance sheet is very strong, yet only 18 months ago the group was being pilloried for not gearing it up more," says the group's head of tax and treasury, Paul Coyle. "But the previous management resisted such calls and time has proved this to be a wise decision. So generally our banks are very happy even if they do have a moan about how little money they are able to make from us."

It's a stance that has received the approval of the ratings agencies. In March Moody's upgraded the group's bonds, awarding them the solid investment grade of A3. Morrisons has also been one of the FTSE 100 stalwarts able to stand aloof from the recent rush of pressured facility renegotiation

Yet when Coyle joined the group in March 2006 he had to set up a treasury department virtually from scratch. One of his very first duties was to put together a revolving credit facility for the group, at a time when the business was beginning to successfully assimilate its acquisition two years earlier of its bigger rival Safeway.

The timing proved particularly fortuitous; a five-year facility was completed in September 2007 just as the credit crunch was intensifying sharply. Although the acquisition of 38 Co-op and Somerfield stores earlier this year was the main factor in pushing net debt up from £458m to £885m – Morrisons spent around £300m on the deal – the facility proved sufficient for the group to avoid having to seek additional finance.

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Instead, back in March this year Morrisons told the City that it had cancelled plans for a £1bn share buyback (originally announced in August 2007) and had instead earmarked £1.1bn for its capital expenditure programme in the coming financial year to take advantage of acquisition opportunities caused by the recession.

Added to this, the group last year announced an "enhanced dividend policy", with the target of accelerating dividend growth ahead of earnings growth so that payments to shareholders were more in line with the company's peers in the sector. When the company reported in September, this policy was reflected in a 35% increase in the interim dividend to 1.08p per share.

STREAMLINED DISTRIBUTION Investment has also been made in improving the group's distribution centres under an optimisation plan, launched initially in 2006-07 with the aim of "settling down" the network in the wake of the Safeway acquisition. The second stage of the plan, due for completion in January, saw the opening of a new centre in Sittingbourne in Kent earlier this year. It provides 900,000 square feet of space and has trimmed an annual 22 million road miles from the group's distribution operations. A second new facility, now under construction at Bridgewater in Somerset and due to open in 2010-11, will provide similar benefits.

First-half results, issued in September, showed the group's gearing with a ratio of debt to equity of 19% compared with 10% a year earlier. As its news release observed, the 2009 figure was still "significantly below that of most companies of a comparable size and nature".

Coyle confirms that Morrisons remains comfortable with a bigger debt load, adding that it compares well with the group's market capitalisation of around £6.5bn. All things considered, he feels that Morrisons is in a "phenomenally blessed place".

He adds: "Our credit facility runs to September 2012 and although we talk regularly to our relationship banks there is no real need for us to do anything at this stage. We will start reviewing a new facility towards the end of 2011. We certainly don't feel any need to look at forward start deals, even though they have become the flavour of the month recently."

The group has a total of seven relationship banks, which reduced from eight when ABN Amro was acquired by RBS. Three are non-UK institutions, these being ING, BNP Paribas and Santander.

Coyle says that each of the seven came into the facility at a significant level and all have provided Morrisons with strong support for a number of years, particularly in the "difficult time" that immediately followed the Safeway acquisition in 2004.

"The total is enough for us as we don't have huge levels of ancillary business to offer," he says. "It would not make sense to have, say, 20 banks and then have to manage the expectations of each of them."

He adds that one of the biggest challenges of the past couple of years has been keeping track of the relationship managers at each relationship bank, due to merger and acquisition deals in the banking sector. In addition to the ABN Amro union with RBS, the group was also affected by Alliance & Leicester's incorporation into Santander.

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CASH COLLECTION Morrisons' steady growth means that the cash collected from its stores now amounts to £7bn a year.

"This passes through our tills and has to be managed. We have a set format and each store complies with it," explains Coyle. "It's a fairly rigid process throughout our network and we are very security-conscious. We have a very tight contract with our current carrier, G4S, with whom we are now renegotiating together with a competitor."

Despite the rise of card payments, the proportion of cash taken by Morrisons stores has shown very little change over the past five years. Cash still represents around 40-42% of the group's overall takings and even its petrol station outlets still see a high proportion of cash transactions. Coyle adds that he imagines the corresponding figures for rivals such as Sainsbury to be "somewhat lower".

"It's possible that contactless cards, such as Oyster, may be taken up in a big way but their transaction limit will have to be increased before this happens," Coyle predicts. "At present the limit is only £10 to £15. That's of little use for a retailer, as our average basket size is well over £20."

The size of that average basket has been growing. The group's feedback indicates it has been able to take some market share from premium retailers such as Marks & Spencer – "although our CFO tends not to mention them individually by name, but as a group", adds Coyle.

However, strong first-half results were accompanied by a warning that sales growth in the retail sector was likely to slow in the second half as unemployment continues to rise and the prospect of tax hikes loom. However, the Morrisons treasury team remains sanguine on the outlook for the group.

Coyle approvingly quotes the observation by Sainsbury's Justin King that money might be tighter but people still need to eat. "That means that we'll continue to grow," says Coyle, "although we'll struggle to maintain the headline growth rates we've achieved recently."

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