Plan for the worst?

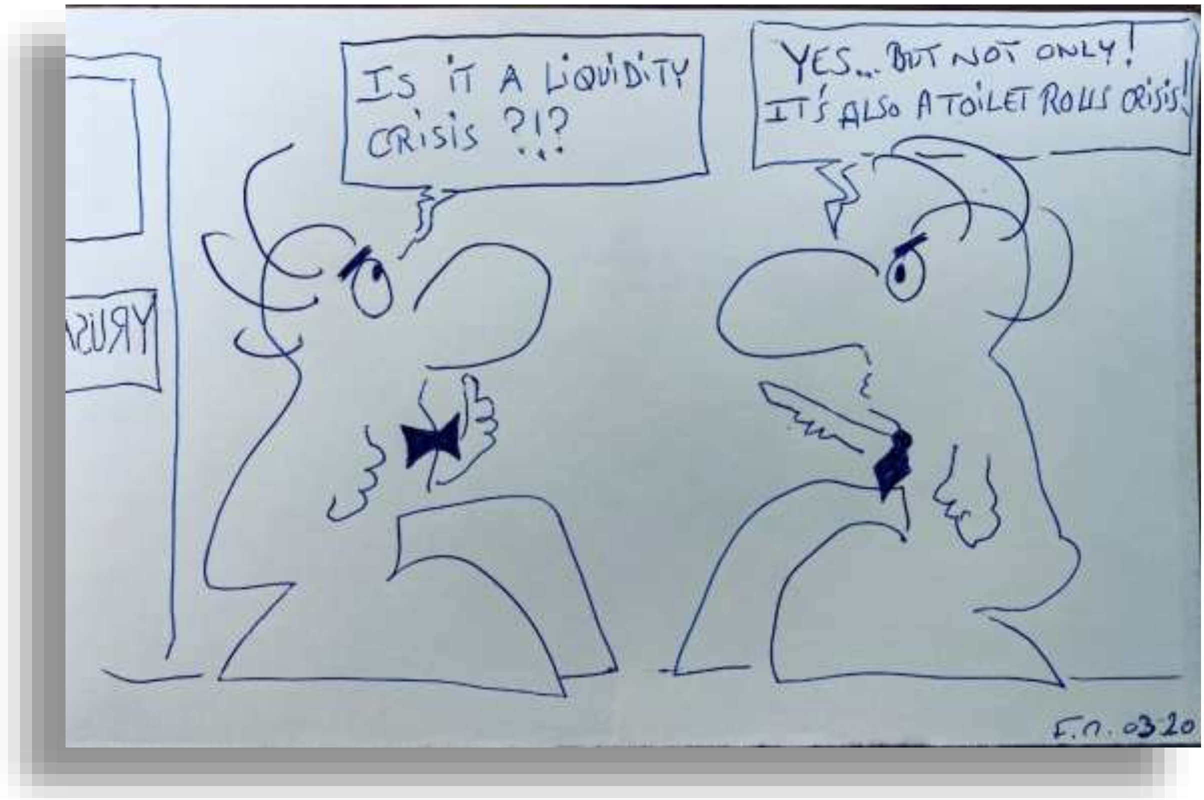
Treasury will be the center of all attention in the coming days and months. The liquidity is re-emerging dramatically for some companies. The current health crisis is exacerbating the risk of no finding enough liquidities. Some other related financial issues will also be the key focuses for CFO's

Treasury, center of all attentions

In exceptional and tough circumstances, treasury get its rights back. It is repositioning at the center of all attentions and cares. CFO's and Boards suddenly realize how crucial and vital it is for the company survival. In such complicate situations, the CFO must focus on (1) cash-flow forecasting to ensure liquidity at any moment, on (2) optimization of working capital needs (also for liquidity reasons) and on (3) capital structure (if possible, to adjust it) and eventually on (4) additional increasing risks (e.g. FX when volatility is increasing, commodities when prices move fast, like oil price now, counterparty risks, which will become also a big issue with risk of default of customers). It is a tough top focuses list. The treasurer oversees all items of this CFO focus list. According to Central Banks, the liquidity risk is a major one if not the most important. It explains their strong actions and recent interest rate cuts (e.g. Fed in US or Bank of England).

Exceptional circumstances call for exceptional measures

People hoard when hard times lie ahead. Like shoppers stripping bare supermarket shelves, MNC's are pulling down credit lines while they can (see recent article on "live stress test" on liquidity I wrote). Panic buying is frowned on. AB-INBEV, the largest brewer in the world, has already dashed to claim what we could call the "first-mover advantage". Be certain, lots of other MNC's will mimic the brewer. A way to prevent liquidity shortage is to draw down all your committed or uncommitted lines to make reserve as these individuals stocking toilet paper. The need for cash in certain sector is huge. Especially sectors worst hit by Covid-19 outbreak, e.g. airlines, travel industry, cruise lines, hospitality, restaurants, … Corporates try to rush to trigger revolving credit facilities on committed amounts ("better safe than sorry"). In the case of AB-INBEV, they draw down 9 billion one shot. It is what I would call "over-precaution", unless they fear a worsening situation. The more interesting point in this story is the pile of cash end of 2019, disclosed in its annual report (i.e. cash & cash equivalent = EUR 6,6 billion). People could think they want to anticipate future bond redemptions or renewals of facilities. The next one which will mature is EUR 3 billion in 2020. Even if the market is dry, they can make it or survive. According to bank analysts, the free cash-flow of AB-INBEV could come down by 6,6 billion in 2020 given closure of bars and restaurants (i.e. down by one fifth). The situation is painful (without any doubt) but not insurmountable or dramatic. The company has a huge debt given its last mega acquisition. The indebtedness has been reduced in 2019 significantly but is still in the range of 95 billion. Net debt to EBITDA ratio came down to 4,5. If EBITDA is declining in 2020, the ratio could come back to nearly 6 times. FORD is doing the same and borrowed 15,’ billion and suspended dividend to deal with shutdown costs.

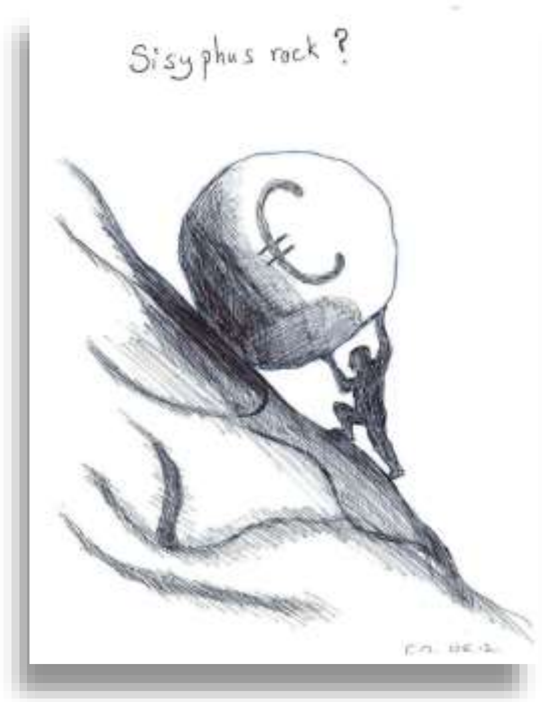


Piling up cash for bad days

There are good reasons for groups to stock and pile up cash these days. If you have a close look at many of the companies (and not only Japanese, the specialists and best cash pilers or German corp’s). Even if you have medium term committed credit facilities, in case of breach of covenants, you can be forced to early repay them or to cure the situation at any price, if feasible. We saw in recent borrowing deals the so-called “Corona clause” which provides borrowers with leeway but pose risk for investors. The idea is to give opportunity to borrowers to absorb hits to their businesses caused by the viral outbreak (or any similar cases). Corporates are keen to give themselves flexibility to cope with shocks beyond the normal course of business. When S&P claimed that in the US the COVID-19 could push default rate above 10 per cent, you understand the use of such provision.

Better safe than sorry

These drawdowns are part of the “runs” on banks in case of financial crisis and it is a major one. Do not forget (on top) the consequences of IFRS 9, new accounting standard on future losses on loans or debtors for banks or corporates. In case of a likely risk of loss on loans, banks will have to book these losses. And obviously, panic borrowing, like panic buying (e.g. toilet paper) or panic selling of equities will make shortages inevitable and create even more complicate situations. CFO’s must resist to temptation to over-prevent and mitigate risks of liquidity shortages. I wanted to insist on the illustrative example of corporate reaction. It is also an additional risk to consider with the group treasurer.



Very low visibility

The problem stems mainly from a lack of visibility, even short one. Cash-flow forecasts are always too slow, too imprecise and too short or too long term (never *ad hoc*). The CFO is badly equipped in terms of instantaneous dashboarding. Who can claim to have made a real-time dashboard available to the CFO? Who can say that the CFO sees the position on cash, FX and risk at any moment in time? What are the KPI's that the CFO has real-time access to, from home? You will have a hard time answering because too often information is provided after the fact (reports are delivered *a posteriori* and at best monthly), with insufficient frequency and in formats too heavy to be read. The problem is essentially a tool problem more than a situation. Without the appropriate tool that will extract information here and there in real time, automatically to consolidate it, how can we claim to be able to decide? So, we adopt behaviors of over-prudence or unconsciousness. Having an effective dashboard is a must. Many still deprive themselves of it favoring the multitude of tools, while these tools exist and are very accessible, I think *FinBoard* for example, a Rolls in this area. The treasurer fishes out of pride and lacks lucidity on the appropriate tool. Let's stop hiding our faces, the "best in breed" tools in place as good as they are, never enable to deliver in real time what the CFO needs. The repositioning of the treasurer, which the crisis will promote, can be magnificent and perfect if he equips himself with the adequate tool. That would be my primary recommendation. I think that a lesson of this crisis for the Treasurer will be the lack of suitable tools preventing the delivery of immediate reports, over-prudence (sometimes a consequence of the lack of relevant pieces of information) and the forgetting of the past. We tend to forget from what we sinned or what was the problem, once we recovered from it.

Working capital and capital structure optimization

After addressing the problem of short-term cash forecasts and liquidity in times of intense crisis, I must address the problem of optimizing working capital requirements. Here, too, there are ways to improve it. Projects of this type are often unsuccessful due to the diversity of stakeholders and the lack of leadership on such a project. The solutions offered by Fintech's exist. As with FX, we need to adopt more dynamic management. Let's bet that many companies will extend their payment terms, as a result of the current situation. The capital structure is also essential because it involves the rating for the most part and conditions the financing, the cost of it, the WACC and indirectly the valuation of the company. It is again overlooked by thinking that the structure is immutable while sometimes over-capitalized or over-indebted. Finally, the satellite risks to be considered during a financial crisis come from FX and commodities, mainly as well as counterparty risk (i.e. banking for those who are "long" and customers for transactions). It has been pointed out that modern IFRS accounting is radical and sometimes terribly cruel. We can expect colossal losses in the coming month, no doubt about it. The treasurer should regain his/her Sioux soul, alert mind and formidable agility to adjust the situation to events. No, the job of treasurer is far from the simplest, far from being the least useful and close to be the post-crisis star function. So, friends and fellow treasurers, be proactive in defending your vital role. You're going to enter the light by the force of things.

Let remain optimistic and remember that we learn from every financial crisis and as Victor Hugo said: "*Even the darkest night will end, and the sun will rise*".

François Masquelier - ***Simply*****TREASURY** March 2020