

Rivers of riches

Corporate finance Balance sheets rebuilt, multinationals are replete with cash – and the way that is deployed will be crucial to the vigour of the global economy, write **Richard Milne** and **Anousha Sakoui**

Feike Sijbesma has a dilemma. But – in common with many chief executives today – it is a pleasant one. DSM, the Dutch life sciences group he runs, has at least €2bn (\$2.8bn) of cash on its balance sheet. “We are sitting on cash – and cash we need to spend,” he says. “The market isn’t pressuring us but we need to act in a certain time frame, yes. We want to do acquisitions.”

It is a remarkable scene being played out in boardrooms around the world. Less than three years on from the dark days of the financial crisis, companies are sitting on a bulging war chest of several thousand billion dollars of cash, according to calculations by financial analysts. What they do with that cash has even become elevated to a presidential matter, with Barack Obama urging US business in February to “get in the game” and spend some of the \$1,900bn sitting idly on balance sheets.

Acquisitions, returning money to shareholders, investment and hiring are all picking up. For example, deal-making through mergers or acquisitions is ahead by 27 per cent so far this year on the same period of 2010, according to Dealogic, the data provider.

How companies spend their cash will be crucial to way in which the global economy recovers. Given western governments’ huge indebtedness, if the private sector continues to save it will act as a big brake on economic growth. Corporate expansion is of particular importance for investment banks, which after a dealmaking drought are thirsty for the return of the fees that had made a large contribution to their overall revenues.

But executives, investors and bankers all suggest that a return to pre-crisis levels of exuberance is unlikely any time soon. Groups will be more cautious, scarred by the crisis and wary about the strength of the upturn. “Companies, albeit with some exceptions, will be more conservative in the future. They will want to keep a bigger cash buffer than they had going into the crisis,” says Rodolfo De Benedetti, chief executive of **CIN**, the energy-to-media conglomerate that is one of Italy’s largest companies.

Colleen Denzler of Janus Capital Management, a large US fund manager, agrees that companies will hold on to more cash as they seek to learn the lessons of the financial crisis. “It is all about confidence. Put yourself in the shoes of a CFO in 2008. They had been increasing leverage, had an underfunded pension fund and so

went into the crisis in a tenuous position,” she says. “You will never put your company back into that situa-

\$215bn

Value of share buy-backs authorised so far this year

tion. So you have been amassing a pile of cash.”

The firepower available to companies is extraordinary. Balance sheets are as healthy as they have ever been, with leverage – the proportion of debt to equity – at its lowest in at least 20 years, according to analysts at the UK’s HSBC. If leverage returned only to the average level of the past decade, they estimate, companies would have an extra \$2,700bn to spend.

Cash represents the biggest proportion of total assets in the US than at any time in the past half century. On top of this, official interest rates in the US and UK are at or close to record lows, meaning the returns on cash are close to zero, providing a powerful incentive to use that money.

Mr Sijbesma thinks companies will delve into their war chests but will be careful not to load up on too much debt. Like many companies, DSM has become attached to its credit rating – in its case single-A – and any acquisitions would have not to threaten it. “The level of leverage we had, before isn’t coming back: first of all in the financial sector, but more importantly also in the corporate sector. That doesn’t mean that everyone can sit on cash. Now the crisis is over, people can’t say cash is king. We have to spend it,” he says.

Mark Aedy, head of Europe, the Middle East and Africa at Moelis, an investment banking boutique, says: “This is my seventh recession in a 32-year career, so we can see from previous cycles that M&A always comes back quickly. With naturally expansionist CEOs out there, I see more dealmaking on the horizon.”

Although the Dealogic figures show 2011 deal volumes reached \$1,230bn by the end of last week, that is still down from the peak of \$1,940bn recorded in the same period of 2007. The change is starker still in Europe, where volumes are down by more than half from 2007. Higher US confidence is evident in deals such as AT&T’s \$39bn purchase of T-Mobile USA. But deals in Europe have included the second-largest cross-border takeover by a Japanese company, with Takeda Pharmaceuti-

cal’s \$13.7bn agreement to buy Nycomed of Switzerland.

Many bankers argue that given the poor returns on cash, companies have to act. The quandary is whether to do

a deal or simply give the money to shareholders through buying back their shares or increasing dividends. Buy-backs have risen this year, with \$215bn of authorisations against \$147bn in the same period of 2010, according to Birinyi Associates, a stock market research firm. But some bankers and investors say buy-backs raise questions about why management will not use the money to fund a company’s organic growth. Instead, they argue, it makes sense to buy growth through an acquisition.

“With the exception of a large cash windfall at a company, investors tend not to be supportive of share repurchases,” says Larry Slaughter, head of European corporate clients for JPMorgan of the US. “Investors want growth they can make sense of and they would rather see a company invest its cash or raise a dividend as a signal of its earnings power.”

Paul Parker, head of M&A at the UK’s Barclays Capital, predicts that the current uptick in deals has a long way to run, with growth of 20 per cent likely this year and next. “If you have a strategic imperative, you could not have a better environment for doing an acquisition: interest rates are as low as they are likely ever to be and high cash balances are earnings dilutive, sitting idly on balance sheets – and investors are beginning again to refrain: ‘Use it or lose it.’”

Still, most of the pressure on companies so far to spend their cash is coming not from shareholders – who largely remain content to give executives some time to come up with investment plans – but from politicians. George Osborne, UK chancellor of the exchequer, noted this year that British companies had cash on their balance sheets worth 5 per cent of gross domestic product. He declared: “What I’ve got to do over the next coming months is to persuade them to start spending that money.”

In his February speech to the US Chamber of Commerce, Mr Obama urged companies to help create a “virtuous cycle” in which they hire more workers, who spend more, thus creating more profits for companies. “Now is the time to invest in America. Today, American companies have nearly \$2 trillion sitting on their balance sheets. I know that many of you have told me that you are waiting for

demand to rise before you get off the sidelines and expand... I want to encourage you to get in the game."

Other investors, bankers and executives, however, paint a picture of companies still cautious about the recovery and unsettled by shocks such as the unrest in the Middle East, the eurozone debt crisis and the earthquake in Japan. Nick Gartside, a chief investment officer at JPMorgan Asset Management, says: "There is future uncertainty. If you look at growth in the developed world, forecasts keep on coming down. If you are a corporate treasurer are you going to invest or are you going to wait and see?"

Just because companies have large cash balances is not the reason they pursue transactions. Banks, particularly in Europe, have been vying for large blue-chip corporate borrowers, so financing is not an issue. The question is what to buy. Some bankers say there are few attractive assets available for sale - and boards are not confident they will get shareholder support for mergers and acquisitions.

Signs of caution can also be seen in the funding mix for deals. Buyers are by historical standards using more shares than had been used to fund deals. In the run-up to the crisis in 2007, according to data from Mergermarket, that year, 70 per cent of deals were funded all in cash; in 2011 to date the figure is 59 per cent - down further on last year.

Some of the companies with the biggest cash piles are not just spending them but also replenishing them. Google, which has \$36.7bn in cash, recently issued its first ever bonds, worth \$3bn. Apple, the computer maker, is also not expected to make costly acquisitions even though

it has cash or equivalent assets worth \$68bn - more than the combined market capitalisation of Nokia, Research in Motion and Motorola Mobility, with which it competes in mobile phones.

The exact nature of cash holdings can be a factor in dealmaking. Some US multinationals have used cash balances held at overseas units to avoid a tax hit that would stem from repatriating that cash back home. Microsoft is using \$8.5bn in offshore cash to buy Skype, the online telecommunications service, which is based in Luxembourg. The US technology heavyweight has about \$40bn in cash in all, yet sold bonds this year, achieving some of the lowest interest rates ever paid by a company.

Another cause of caution is distrust of banks, after the financial crisis prompted many lenders to withdraw credit lines or push up what they cost. Siemens, the German engineering group, went so far as to found its own bank to reduce its reliance on lenders. Gibson Smith, chief investment officer at Janus, says: "I think many companies are sceptical that Wall Street will be there if they need liquidity. They will run larger liquidity balances than they did historically."

Industrialists echo those sentiments. "Today, many big companies are more cautious than in the past, after having directly experienced market volatility and funding difficulties during the most acute phase of the crisis," says Mr De Benedetti. "Having cash in hand in this kind of market context is a bit like having an insurance policy against the risk of financial tension."

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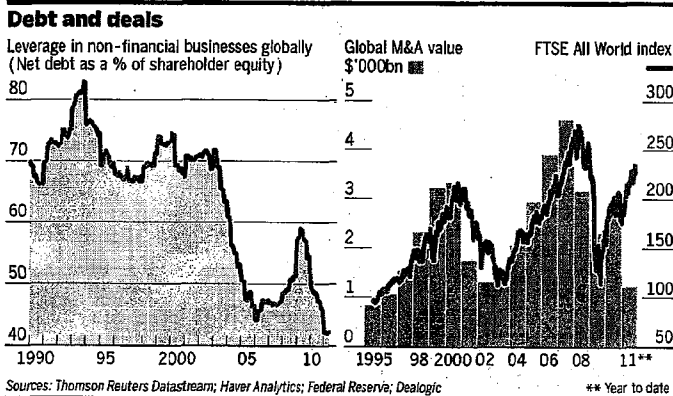
A relatively few signs of exuberance in M&A. Mr Slaughter says: "There is a lot of macroeconomic uncertainty and companies are being more careful. Companies have learnt lessons from the crisis: to have their own funds and not rely on the bank community. There is still a lot of caution among corporates not to overpay for acquisitions."

One deal cited by some as an exception is Microsoft's recent takeover of Skype. This saw a \$5bn windfall for a group of investors, led by Silicon Valley investment firm Silver Lake, who bought the company 18 months previously. Adding to fears of frothiness in the technology sector was last week's flotation of LinkedIn, as shares in the business-focused social network more than doubled on their opening day.

Richard Batty, investment strategist at Standard Life Investments, says he is heartened by the fact that most acquisitions are so-called "bolt-on deals" rather than large, transformational ones. But he adds: "The big risk is that companies' acquisitions are too aggressive, that too much cash is taken off balance sheets, leaving not enough room to grow dividends or embark on share buy-backs."

It is a concern that corporate executives are keen to address. In spite of the huge inflow expected from its sale of T-Mobile USA, Deutsche Telekom has ruled out any multibillion-euro deals. Instead, it plans to use the proceeds to reduce net debt by €13bn and fund a €5bn share buy-back.

For now, at least, it seems as if Deutsche Telekom is more representative of companies' behaviour than Microsoft. Mr Smith of Janus says: "We meet so many management teams that say 2008 was a tremendous learning experience for us and we are not going back to balance sheets like that". Corporate conservatism is here to stay."



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'We have to spend it': Feike Sijbesma of DSM

