The Corporate Cash Question

Treasury Strategies

High Corporate Cash:
Hoarding or Responsible Financial Management?

Corporate cash and short-term investments are at record highs – both in absolute numbers and as a percent of total revenues. At $1.8 trillion in the U.S. alone, cash is up 25% since the beginning of the recession. Corporate executives are under pressure to put that cash back to work. Indeed, there have been charges that “cash hoarding” is prolonging the recession. Treasury Strategies worked with our clients to better understand the underlying business decisions leading to these historic cash levels.

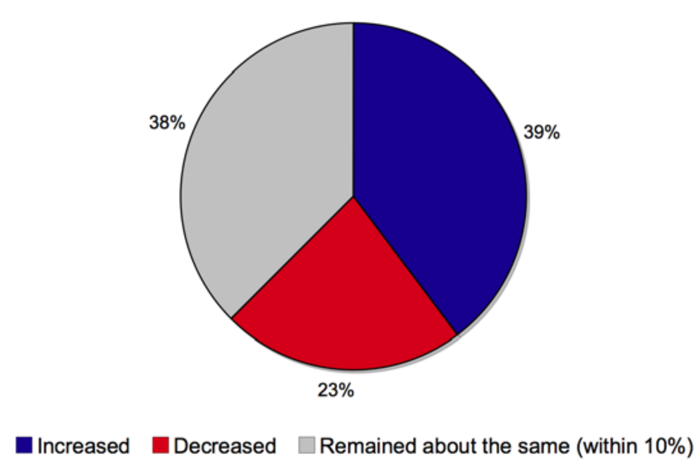
Overview

We surveyed 300+ clients during two weeks spanning August and September 2010, and found 300 independent perspectives – that combined to result in higher cash levels.

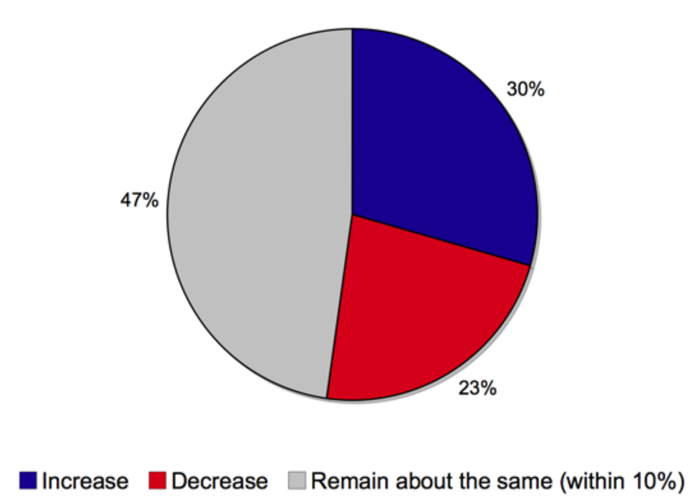
We identified several explanations for why cash remains elevated. These stories could be missed entirely if one were to focus only on the $1.8 trillion headline number.

For example, during the past six months, while 39% saw increased cash levels, 23% actually decreased cash. In projections for the next six months, the gap narrows to 30% increasing and 23% decreasing. The reasons for these changes vary widely.

Corporate Cash Levels Over the Past 6 Months



Corporate Cash Levels Over the Next 6 Months



[1] $1.8 Trillion is an estimate noted by the Federal Reserve report, *Flow of Funds Accounts in the United States.*

A Key Theme

Cash flow from operations is by far the dominant driver for cash levels. In the past six months, 88% of companies with increased cash levels ranked "improved cash flow from operations" as either their first or second factor for increased cash levels. On the opposite end of the spectrum, 54% of companies with decreased cash identified "negative cash flow from operations" as the major factor for their lower cash levels.

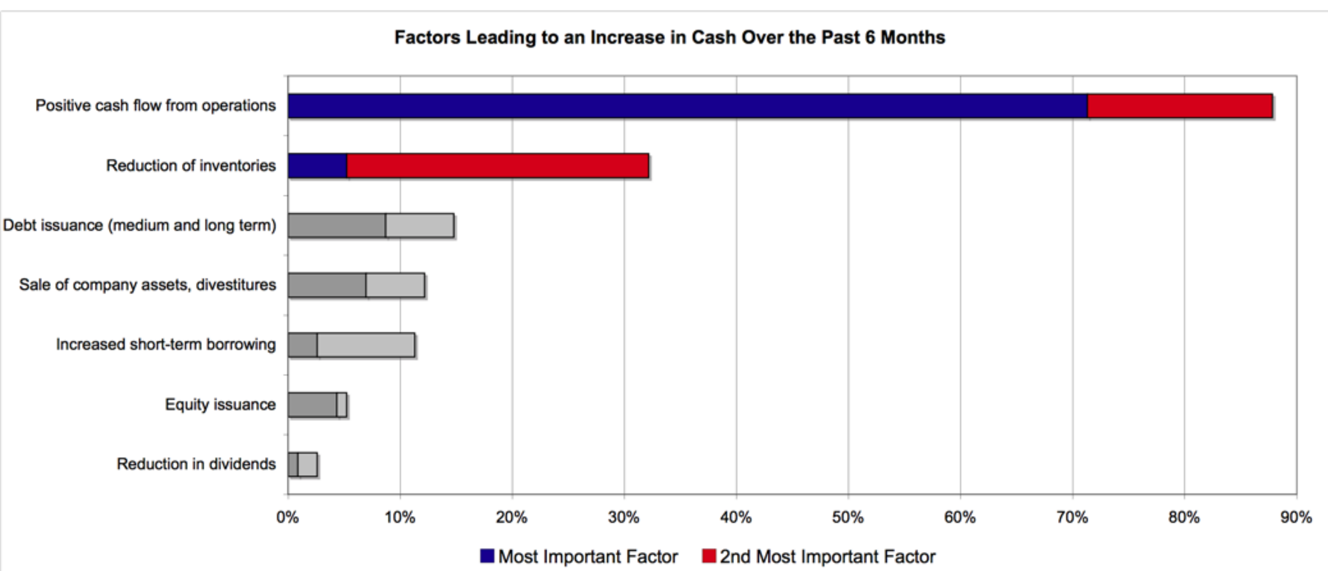
This pattern indicates that cash levels have increased for many firms as a result of improvements in their day-to-day business and independent decisions they have made for the good of their individual companies.

The Past Six Months

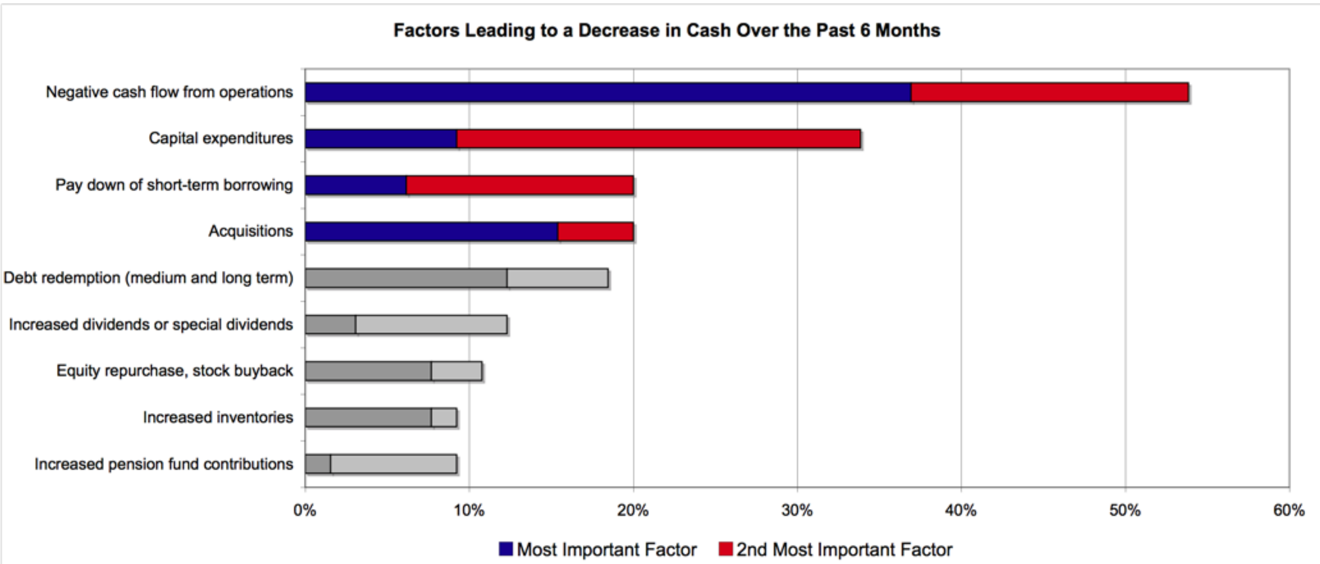
To gain context and a sense of overall trends, we look to the past six months.

Cash Levels – The majority of companies, 62%, indicated some change in their cash levels. This high degree of change demonstrates that corporations were continuing to fine tune their liquidity equation.

Driving Factors to Increase Cash – "Positive cash flow from operations" was noted by 88% of companies as either their 1st or 2nd most powerful driver of increasing cash over the last six months. The second most often cited driver was "reduction of inventories" at 32%.



Driving Factors to Decrease Cash – Interestingly, 54% of corporations said "negative cash flow from operations" was also the main driver for decreased cash. The second most often cited driver was "capital expenditures" at 34%.

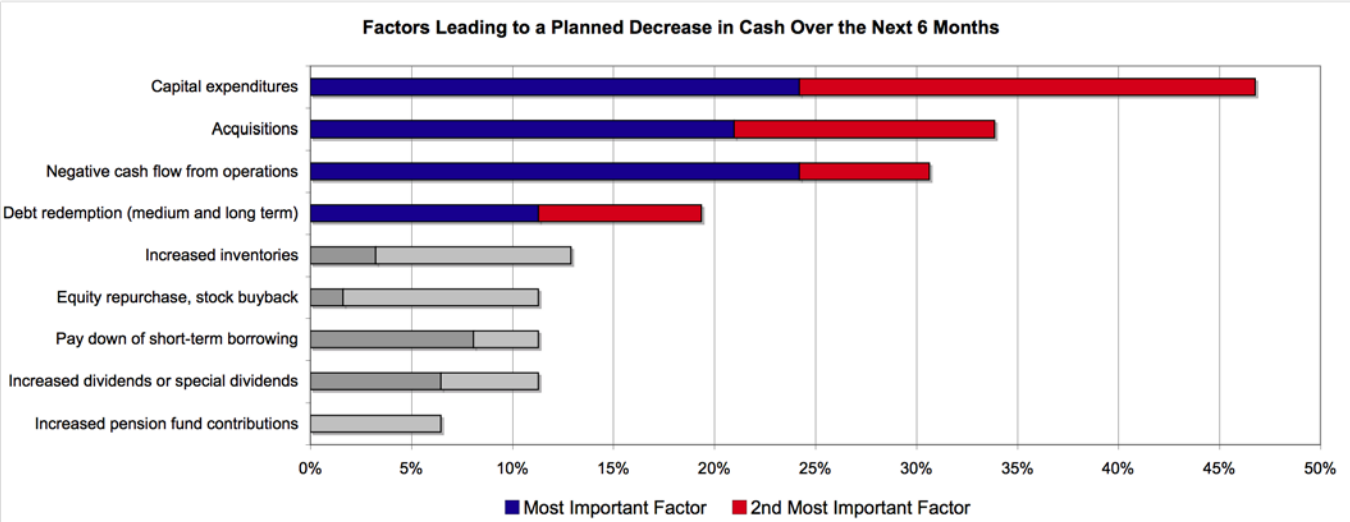


The Next Six Months

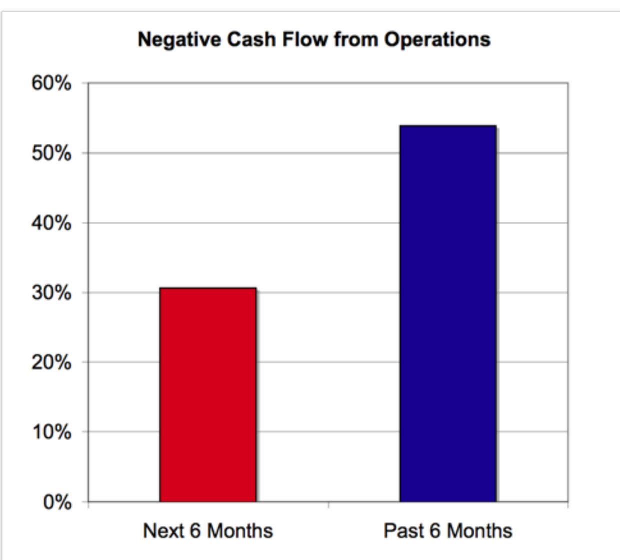
Looking forward, a number of signs indicate the business outlook is becoming more optimistic.

Cash Levels Gap – The last six months saw a 16% gap between companies that increased vs. decreased cash. Looking forward to the next six months, that gap narrows to just 7% (30% increasing and 23% decreasing), which indicates cash levels may be close to peaking.

Decreased Cash from Operations – In the past six months, 54% of companies whose cash declined cited "negative cash flow from operations" as a leading reason. Projecting forward, that figure drops to 30%, which suggests the number of companies bleeding cash is going down – a positive sign that business is improving.



Plans to Decrease Cash – Of the companies expecting their cash levels to decline, 47% indicate capital expenditures as the 1st or 2nd driver for that decrease, 34% expect acquisition activity, and 30% cite negative cash flow from operations. These figures are a strong indication that cash is about to be re-deployed into the marketplace and businesses have plans to grow.



Other Drivers of Cash Levels

Balance Sheets – Corporate balance sheets may have stabilized. In the past six months, 11% of companies increased borrowing, 15% issued medium or long-term debt, and 5% issued stock. Predictions for the next six months drop to 7%, 8% and 4% respectively.

Reduction of Inventories – Over the last six months, 32% of companies said they generated cash via inventory reductions. Looking forward, that number increases slightly to 36%. This trend is a negative indicator because inventory replenishment is usually a major sign of an economic turnaround.

Dividends – Of companies expecting decreased cash levels, 12% expect to issue “increased or special dividends” in the next six months. This trend may indicate an intention to return cash to shareholders before the dividend tax rate increases at year-end.

Pension Plans – Just 5% of companies indicated they plan to use cash to increase pension plan contributions.

Large vs. Small Companies

Large Corporate = ≥ $1 billion in annual revenue
Small Corporate = < $1 billion in annual revenue

Debt – Of firms with increased cash over the last six months:

- 24% of large corporates issued medium- or long-term debt vs. 8% of small corporates.
- 16% of large corporates increased their short-term borrowing vs. 8% of small corporates.

Growth Plans – Going forward, companies expect to decrease cash through a combination of acquisitions and capital expenditures:

- 43% of large corporates and 21% of small corporates anticipate a possible acquisition.
- 40% of large corporates and 50% of small corporates plan capital expenditures.

Using cash for acquisitions and capital expenditures are rational behavior one expects to see as an economy comes out of recession.

Additional Insights

- As a result of the crisis, treasurers have exercised more conservative portfolio management, both in terms of maturity and credit quality. Firms anticipate being only slightly less conservative going forward.
- One-third of all companies have implemented new cash management technology since the start of the crisis. To have so many companies improving their systems is a sign of an increasing need for technology to provide meaningful intelligence and strategic business support.
- Two-thirds of companies indicate increased reliance on cash forecasting – something they typically do when they believe there is less margin for error. There is substantial opportunity for companies to improve the value and accuracy of their cash forecasts through periodic process and technology reviews.

Outlook on Liquidity and the Recovery

Corporate cash is indeed at record levels. However, our clients told us that the growth rate is declining. We saw considerable differences among the 300 companies with whom we discussed this issue.

There was no evidence, whatsoever, of hoarding or a coordinated capital strike. Rather, companies were making rational individual decisions regarding inventories, capital expenditures, borrowing, debt repayment, acquisitions and dividends within the context of their operating cash flows.

Companies need appropriate amounts of cash and access to credit in order to fund working capital requirements. When credit was scarce, or expected to be scarce, many firms held more cash. That cash was raised through a variety of mechanisms to keep the liquidity equation in balance. Such responsible actions have kept companies in good operating condition through a tremendously challenging economic period.

Chicago l 309 W. Washington, 13th Floor l Chicago IL 60606
London l 1 Northumberland Avenue l Trafalgar Square l London WC2 N5BW
New York l 61 Broadway, Suite 905 l New York, NY 10006