

# Key Takeaways from NeuGroup's Tech20 Treasurers' Peer Group 2019 H1



*Tech company treasurers talk about how to get the whole company thinking about cash, floating rate debt, synthetic leases, treasury's value and more.*

## Broaden Scope to Think Cash, "End to End"

**Treasury organizations can drive home the idea of the entire organization thinking about cash.**

A member shared his treasury organization and the plan to scale it with the growth of the company while containing cost increases.

The underlying structure—one that encompasses a broad treasury and finance organization (TFO)—will support this objective in many tangible and intangible ways.

**Broadening the scope.** Consolidating all the company's functions that touch cash and forecast and manage exposures under the treasurer, including FP&A and credit and collections,

makes for a large group, but it bolsters the treasurer's strategic influence at a leadership level.

**Why rotations are important.** The willingness to rotate increases with the elimination of phrases that evoke old-school status tiers, like front and back office. Using an updated vernacular can do wonders

for cohesiveness, plus it makes it more attractive to rotate between positions to develop functional and management skills while still maintaining efficient ties to the team.

**Scaling, price tag in mind.** The imperative to scale, i.e., grow cost-effectively, will be accomplished the presenting members' company by shifting more of the team from high- to lower-cost locations, and automating and innovating to avoid having to grow the team much bigger, or even being able to reduce the team over time.

## Maturity or Crisis Can Increase Treasury's Value

**Treasuries at fast-growing companies will gain value with maturity, but a crisis can accelerate that value.**

Several threads of conversation over the day's meeting related to treasury's ability to demonstrate its value-add. In a young, fast-growing company, it may be imperceptible next to the impact of business growth and other results, but as the company matures and growth slows, the impact of treasury's funding and risk-management decisions becomes more noticeable. (Of course in a crisis, this is even more true, as we saw in 2008. But memories are short, as we know.)

**No dividends, buybacks too soon.** One member pushes for a mindset of resisting allocation shifts like the initiation of dividends and buybacks, which create the perception of maturity prematurely. Maintaining high-growth practices and attitudes, which can signal continued growth to investors, is a better option.

**That said...** The challenge, though, is to determine what KPIs are meaningful for treasury in high-growth companies, both to demonstrate success and value-add and to motivate the team toward world-class practices, as another member pointed out.

## Cap Structure: A Bank's View

**Sponsor SocGen shares its thoughts on cash levels, dividends, buybacks and more.**

Responding to the evergreen topic of capital structure optimization, sponsor SocGen provided thoughtful overviews on a couple of topics:

### **1. Optimal level of cash for efficiency and resilience.**

Resilience of course is the ability for something to withstand disruption. Having the right amount of cash defends against



disruption; too much cash and activists come knocking; too little and your company is in a fragile state, particularly in an economic downturn. SocGen adds that another goal is to

“maintain sufficient cash on the balance sheet and a large enough revolving credit facility to maintain a strong liquidity rating with S&P through the various scenarios identified.”

**2. Dividend vs. buyback optimization.** SocGen says to “consider the importance

of maintaining dividend growth if applicable.” But be aware that the company will “have years in a severe downturn when capital returned to shareholders exceeds cash flow.” There should be a plan, therefore, look for opportunities to “return cash beyond the dividend,” such as share buybacks, in strong years with the ability to “dial it back” in leaner years.

## Synthetic Leases Make a Return

**Synthetic leases offer many benefits and should be considered before taking control of any new real estate.**

With new lease accounting rules (ASC 842) taking effect in January 2019 requiring operating leases to be recognized on the balance sheet, synthetic leases are back in play. This is particularly relevant for real estate, providing benefits in areas of ownership for taxation while reducing balance-sheet leverage.

**What’s important.** Don’t take control of a new real estate asset before considering a synthetic lease. Otherwise treasurers can miss out on earnings per share benefits (synthetic lease rents are significantly lower than the rents of traditional real estate leases); cash-flow statement benefits (synthetic lease financing removes the related CAPEX from the cash flow statement); balance sheet benefits (synthetic lease balance sheet exposure will be 10%-20% of asset cost versus 80%-100% for alternative lease structures or debt financing); rating agency benefits (rating agencies will default to the new lease accounting rules when considering elements to be included in leverage and coverage ratios, which has traditionally excluded residual value guarantees).

## SocGen: You Have Less Floating-Rate Debt Than You Think

**Therefore, your floating-rate debt capacity could be higher than you think.**

Another eye-opener for many Tech20 attendees was SocGen’s suggestion that their floating-rate debt capacity was higher than they (most likely) currently thought it was—provided they hedge their FX, that is.

**Why?** Because, according to this view, the FX hedge program reduces one’s net floating debt exposure. In addition, if you agree that a recession is coming, rates will be staying put or going lower, making floating debt even cheaper.

**It pays to favor floating-rate exposure to interest rates now.** Treasurers often fight against the bias that locking in fixed-rate exposure to interest rates is best. In fact, most studies show that relying on floating-rate debt is cheaper. Back-testing by SocGen showed that since 1990, a 10-year floating strategy was cheaper 100% of the time, with average savings of around 3% vs. a fixed-rate strategy.

**Now it may be even better.** In the US, for instance, an anticipated rising rate environment was suddenly paused by the Fed, and monetary policy indicators increasingly suggest that not only are we unlikely to see interest rates normalize any time soon, but they may well be headed down again. When the yield curve flattens or inverts, moreover, as it has, the timing to increase floating-rate exposure to ride interest rates lower cannot be better.

**Include FX hedging program in offsets.** Disciplined asset-liability management seeks to offset floating rate-liability exposure with floating-rate assets. Depending on a firm’s risk profile and appetite, the offsets can match completely, or the floating-rate assets can be seen as a means to increase floating-rate liability further. This is where Societe Generale’s insight caught our members’ attention, namely that the FX hedging programs—factoring the cost of hedging long cash-flow and balance-sheet exposures—for many US firms represents a floating-rate liability offset.

**How it works: Decreasing USD rates increase cost of hedging.** Seen from the perspective of FX swap points that comprise the forward rates of foreign exchange, a US firm paying very low EUR rates and receiving higher USD rates (that could be trending lower) represents an offset to float-



ing-rate debt exposure. The reduction in carry gain (e.g., on EUR) or increase in carry cost, (on MXN) for example, from an 100bps decrease in USD rates increases the ALM capacity for floating-rate debt exposure.

## Start Thinking SOFR Shift Now

***Moving to a SOFR-based benchmark rate won't be a choice for long.***

SocGen's Subadra Rajappa, who is a member of the committee on the transition from the tainted Libor to the new SOFR, noted that there are contracts with a notional value of more than \$200 trillion that are linked to Libor and close to \$10 trillion Libor-based cash products out there, making the task of transitioning these products to the new benchmark "immense."

**End of (Libor) days.** The closer the market gets to the 2021 "end of Libor," Ms. Rajappa said, the less carrot and more stick it will see in terms of getting market participants to shift.

**The upshot.** It's time to take inventory of your derivatives and investment portfolio to get a handle on how many Libor-linked items there are, what contracts say about replacing

benchmark rates, actions required and the ripple effect on in- and outflows and processes and systems.

## The Bots Are Coming

***What are the benefits of treasury automation?***

Digital platform provider Automation Anywhere offered an overview of the potential benefits of treasury automation.

**Conventional view.** The prevailing view is that you want to maximize the automation functionality of your TMS and ERP before adding automation provided by third parties.

**The reality check.** In reality, how much will that cost and where are you in the IT department's project queue? In that analysis, a \$10,000 bot may be worth it if it handles manual tasks for your already lean team. One member who was particularly energized by the presentation suggested that perhaps the tedious process of SOX compliance could be automated, which would be a win.

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